Canada

The State of Competition in the Canadian Petroleum Industry

Volume V

The Refining Sector

Director of Investigation and Research
Combines Investigation Act

The State of Competition in The Canadian Petroleum Industry

Statement of Evidence and Material Submitted to the
Restrictive Trade Practices Commission in Connection with an
Inquiry under Section 47 of the Combines Investigation Act

relating to

THE EXPLORATION FOR, AND THE IMPORTATION, PRODUCTION, PURCHASE, MANUFACTURE, STORAGE, TRANSPORTATION, DISTRIBUTION, BARTER, SUPPLY AND SALE OF CRUDE OIL, PETROLEUM, REFINED PETROLEUM PRODUCTS AND RELATED PRODUCTS

by

Robert J. Bertrand, Q.C.,
Director of Investigation and Research
Combines Investigation Act

Volume V — The Refining Sector

This is one of a set of seven volumes comprising the Statement of Evidence and Material submitted to the Restrictive Trade Practices Commission in this matter by the Director of Investigation and Research under the Combines Investigation Act. The volumes comprising this Statement include:

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THE REFINING SECTOR

A. *Introduction*

The refining sector, unlike the marketing or production sectors, provided a natural focal point where the majors were able to coordinate their policies and to affect competition adversely. This was facilitated by several factors. First, refining provided an interface between the production, importing, and the marketing sectors and was, therefore, a natural coordinating point. Secondly, the refining sector was more concentrated than either of the other sectors. The production sector had a large number of producers and the marketing sector, although dominated by the majors, possessed a fringe of independent marketers. In contrast, the refining sector in each Canadian region consisted generally only of the majors — national and/or regional. Even where this was not the case, the importance of the smaller independent refineries diminished over time. Thirdly, the natural level of monopoly power arising from the high level of concentration in refining was reinforced by the degree of inter-company coordination in this sector. Companies which owned refineries met with one another for the purpose of trading product. The resulting arrangements took the form of exchanges of product, of purchase/sale agreements, or of processing arrangements. Two aspects of these various refinery agreements served to weld the refiners together. First, the pattern of linkages was such that a set of bilateral arrangements tied all of the national majors together into one all inclusive network. In addition, the linkages between each regional major and one or other of the national majors served to tie these secondary firms into the main unit. Secondly, the nature of the agreements was so complex that a degree of coordination was required that served to mesh the interests of the parties to the agreement; the product exchange arrangements were often long term and involved more than one region. The arrangements were characterized by substantial inter-firm communications and discussions regarding distribution systems, product demand and supply estimates, and the timing of refinery construction and expansion. Arrangements as complex as these required more than just tangential linkages between firms; they resulted in a substantial meshing of the operations of the various participants.

Not only did the refiners as a group have the type of control associated with a monopolistic situation but they also used the discretionary power associated with market contol to entrench their position. On some occasions this power was exercised by one company alone. On other occasions it was exercised jointly or with some degree of coordination. In both cases, the exercise of discretionary power served to enhance the monopolistic position of the majors.

The monopolistic position of the major refiners was enhanced because of the way in which the majors organized the inter-refinery agreements. The purpose of the refinery agreements was not only to rationalize the industry but also to deter entry and to strengthen interdependence in the refinery sector and, as a result, to reduce competition at the wholesale and retail level in the marketing sector. By exercising a certain degree of control over 'tradeable' capacity the leading firms were able to maintain upward pressure on prices in the marketing sector and to reduce the number of marketers competing on the basis of price.

The majors were able to constrain competition downstream in marketing by developing and applying a selective supply policy. This involved appending restrictions, either explicit or implicit, to supply agreements. Restrictions such as market sharing agreements, territorial exclusivity, or 'normal market growth' clauses served to restrict the ability of one party to grow at the expense of the other. In addition, refinery agreements were either withdrawn or changed if one party did not follow the expected behavioural pattern of mutual forbearance in the marketing sector. Finally, potential entrants to refining were treated differently depending upon their potential to compete with existing refiners. Firms, with little chance of entering the refining sector, were either not offered product on the same terms as existing refiners, or were denied it. When entry did occur, the existing refiners would then offer to enter into product supply arrangements with the intent of exercising a controlling influence over the new firm by meshing its interests with the existing group.

It was the actions adopted against the independent marketers at the refinery level that clearly demonstrate the anti-competitive objectives of the major refiners. Particular attention was focused by the majors on restricting the access of independents in the marketing sector to product supply. The imposition of restrictions on the disposition of product by parties to an exchange agreement was one way in which this was done. These restrictions were aimed at preventing product from being passed on to independents by refinery customers. Squeeze tactics were also employed against the independents in both refining and marketing sectors. It was the discretionary or monopoly power possessed by the major refiners that allowed the squeeze to be undertaken from the wholesale side. As was the case with other actions of the majors at the refining level, these policies were directed towards restraining competition in the marketing sector.

B. *The Relationship of the Refining Sector to Other Levels of the Industry*

While none of the levels of this vertically integrated industry can be studied independently this is especially true of the refining sector. Arrangements that were made in this sector impacted upon the performance of the industry at other levels. For instance, inter-firm agreements in the refining sector facilitated

development of a common policy by the majors in the marketing sector. The refinery agreements tied the interests of the various majors so closely that the difficulties normally associated with reaching or enforcing the adoption of common policies, such as were implemented in marketing, were overcome. This was accomplished in one of two ways.

First, explicit reciprocal agreements as to the amount each firm could lift from the other's refinery were used to create a form of market-sharing arrangement between firms. Usually, market-sharing arrangements are described as interfering with the competitive process because, by guaranteeing each firm a fixed share, they reduce the individual firm's perceived elasticity of demand and the incentive to reduce prices. While some of the market-sharing arrangements at the refining level worked in this fashion, their impact was generally felt in a different manner. The reason for this lies in the form of market-sharing arrangements created by reciprocal agreements. Reciprocal agreements specified that the amount of products lifted by each company from the other's refinery would be approximately the same. These arrangements, therefore, fixed the relative market shares in the sense that neither firm could expand in the territory of the other and increase its share of both markets.[1] If a company began to increase the amount of product it took from the other in the latter's home territory and, in turn, adopted an aggressive pricing policy for marketing purposes, it knew the terms of the exchange would facilitate immediate retaliation. Of course, even without reciprocal arrangements, retaliation could be forthcoming — but only when the contract had expired. In the case of reciprocal arrangements, the partner losing market share in his home market would have the right to increase its product liftings from its partner and to create immediately a similar price deterioration in the home market of the firm which initiated price competition. Reciprocal agreements, therefore, were an extremely effective instrument for solving the discipline problem any oligopoly must face in that they decreased the reaction time needed to counter aggressive behaviour.

A second characteristic of the refinery product exchanges also served to weld the interests of the various refiners together. For product arrangements involved detailed exchanges of information among companies at the refinery level. An oligopoly's stability is inversely related to the information available to each of its members about the respective strategies of the others. Solidarity and the maintenance of oligopoly discipline depend upon the trust that develops among members. Trust is engendered if information about each member's activities is so detailed that individual companies can be certain that others are

1. Let Qij be the i'th firm's supply in the j'th region. Firm i produces only in i, firm j produces only in j. Then reciprocal arrangements that guarantee $\Delta Q_{ij} = \Delta Q_{ii}$, mean that $\sum_{j} Q_{ij} / \sum_{j}\sum_{i} Q_{ij}$ is constant for any change in Qij, $i \neq j$.

abiding by the oligopoly's rules. Comprehensive exchanges of information among companies at the refinery level provided what was required for this purpose. In turn, the exchanges of product provided a monitoring device as to the accuracy of this information. That each major was able to evaluate the intent and the activities of the other majors and then to adopt a reinforcing pattern of behaviour in the marketing sector can be attributed to the degree of interdependence that developed in the refining sector.

While evidence will be presented to show that product arrangements at the refinery level were deliberately entered into in order to acquire information that could be used to inhibit competition, it should be stressed that informational exchanges need not have been adopted with the intent of facilitating oligopolistic coordination to the detriment of competition. When economies of scale are important, as in the refining sector of the petroleum industry, exchanges can be in the interest of competition if they facilitate the independent operations of more firms than the technology of an intermediate input would otherwise have dictated. These exchanges of product must necessarily be accompanied by the exchange of some information. In this sense, some industry communications might be regarded as a necessary by-product of a process that prevents the massive economies of scale that exist at the refining level from causing a similar level of concentration to develop in marketing. Therefore inter-refinery product trades and the accompanying exchange of information need not be harmful to competition.

Whether or not an exchange of product is harmful to competition depends on the specific circumstances. For instance, an exchange may be organized in such a way as to prevent the potential benefits to competition that having more than one marketer in a region promises. If a product exchange changes the structure of the industry in one region from one firm to two firms which act jointly, the competitive process is harmed in that the public interest in free competition which could result from the change in structure is precluded. Two firms are likely to act as one when the terms of the exchange impose unnecessary side conditions that prevent independent action by the parties to the agreement. Evidence will be presented to show that this was the case in the Canadian refining sector. In addition, the competitive process can be harmed if the type and extent of information exchanged extends beyond that which is required for a product exchange. Through the exchange of information there may be a deliberate attempt to mesh individual interests at the refining level in order to facilitate the task of coordination downstream in marketing. There is, therefore, no presumption that the types of exchanges actually adopted in the refining sector were beneficial. Indeed, this study indicates that the opposite was true. The agreements reached in the refining sector had an adverse impact on the performance of the marketing sector. Moreover, they were deliberately designed to do so.

Marketing was not the only sector which interacted with the production sector to reinforce the monopolstic conditions that developed in each other. In the case of the production and the refining sectors, the effects of agreements reached at each level extended to impact upon the other level. For instance, control of crude in the production sector permitted the two leading firms to exert a leadership role in the price setting process. It also offered a credible disciplinary threat that helped to bring producing firms together to set prices and to restrict production when the price structure was threatened. Crude control was also used to create a price structure that did not reflect relative values and to direct the 'preferred' crudes to favoured refineries in such a way that smaller refiners were either eliminated or always faced the threat of being eliminated if they did not abide by the marketing policies of the oligopoly. In this sense, the agreements reached in the production sector affected the structure of and the nature of agreements reached in the refining sector. However, the predominance of the firms that gained a majority of 'crude control' in production was partially the result of the predominance of the same two firms in the refining sector. The size of their crude oil purchases allowed them to extend their control to crude that was not directly used by themselves but sold to third parties. In this way, the structure and performance of the refining sector influenced the structure and performance of the production sector.

The nature of the interdependence that developed among the majors in the refining sector also affected the behaviour of the industry with regards to the acquisition of foreign crude oil. The subject is dealt with in the volume of this study dealing with international linkages. There, it was demonstrated that high crude oil prices charged to Canadian firms were used both to create and then to transfer abroad monopolistic profits from that part of Canada served by offshore crude oil. This was accomplished not just because one multinational followed a policy of extracting inordinately high transfer prices from its Canadian subsidiary but because most of the majors followed a similar policy. Various methods served to keep the different companies' policies in harmony one with another. In particular, coordination of pricing policy was facilitated by the interdependence that developed at the refinery level for two reasons. In the first instance, processing agreements resulted in the coordination of transfer prices for crude oil. In the second instance, the daily contact that developed at the refining level was used to exchange information on the crude prices that different firms were using. Partly as a result, a common course of action was adopted with respect to transfer prices by most firms in the industry.

The interactions that developed between the different levels of this vertically integrated industry provide one reason for relating the refining sector to the others. That the arrangements which were achieved at each level bore a striking similarity and that the identity of the firms entering into these

arrangements was the same, provides a second reason. These similarities support the contention that the actions of the industry at every level consistently served to interfere with the competitive process. Of course, the structure at each stage of this vertically integrated industry was not the same and the types of arrangements that were used to deter competition varied to some degree. Nevertheless, the parallels in the industry's behaviour are sufficiently numerous to suggest that the series of arrangements that characterized each sub-sector were not unconnected. They served to coordinate the actions of the majors at all levels and to create monopolistic conditions that were exploited in a fashion that was inimical to the public interest.

An industry model can be found in the refining sector that was similar to that found in both the production and marketing sectors. In the marketing sector, Imperial was the price leader and recognized that other majors would generally follow its lead. In the production sector, Imperial also adopted a leadership role. A second firm — Gulf — also wielded some power and served as the point around which the other firms sometimes coalesced. This meant that Exxon's Canadian subsidiary was able to take the lead in establishing a pricing mechanism. For the same reason, it was able to gain acceptance from the rest of the industry for the pricing formula that it set. It is significant to note that Imperial was not the only Exxon subsidiary to find itself with a leadership role. Humble, the Exxon operating subsidiary in the United States, also found that it could count on the rest of the industry to follow its leadership. The following quotation shows how Humble deliberately delayed development of alternative crude oil and energy sources knowing that this would encourage most of the industry to do the same. Exxon's strategy with regard to new sources of crude in shale and coal were described:

> "It is therefore desirable for Humble to do research work on shale and coal to know where these processes are headed and thus be in a position to anticipate government moves and be able to enter the field vigorously if commercial production commences. Humble should also encourage the government to initiate some private leasing of shale acreage but at a very restrained rate. In the meantime, it should not itself initiate commercial production, or take other action or make announcements that would motivate other companies to initiate commercial production or even development. It is felt that there is a fair amount of mass pyschology in the industry and that, while many companies would prefer to go slow because of their domestic crude interests or because of uncertainties about the state of development of synthetic technology, they would feel compelled to start plants if others did and particularly so if a company with the stature of Humble did."
>
> (Document # 109009, January 25, 1968, Imperial)[1]

Imperial dominated not only the production but also the refining sector. Throughout the period under study, it was the only firm with facilities in each Canadian region. Gulf was second and had similar geographic representation — at least by the end of the period. While both of these firms entered into

arrangements to supply or to receive product from other majors, Gulf's links with the rest of the national majors were more extensive than those of Imperial. Therefore, in refining as in production, Imperial dominated while Gulf headed up a second group whose interests were closely coordinated.

Not only was the hierarchical structure in refining and production similar, so too were the intentions of the leaders to 'control' the industry. While control meant different things to the industry in different sectors, its effect was similar in each area. It strengthened oligopolistic interdependence and served to weld separate firms into a cohesive unit with common goals and the ability to restrict competition from outsiders. In the crude oil sector, it was Imperial's objective to 'control' as much crude as possible; by doing so, it was able, directly and indirectly, to set the price structure and to control the disposition of crude to others. In the refining sector, Imperial's objective was also to 'control' the industry — via control over 'spare' refining capacity. In doing so, it felt it could influence the disposition of product and maintain control over the type of marketers who might obtain supply. Indeed, it is the manifestation of discretionary power in the latter area that provides evidence of the effectiveness of the arrangements reached at the refining level that were directed at entrenching and maintaining the monopolistic power of the majors.

It is also the case that the production and the refining sectors were both characterized by joint operations. In the production sector, joint exploration agreements, land exchanges, and crude trades were arranged. In refining, the same jointness of operation was achieved via various forms of refinery product exchanges. In both cases, the type of agreements were extensive and served to link the interests of the participants very closely. For instance, in the production sector, an agreement was signed in 1945 that tied the exploration efforts of Imperial, Shell, Gulf and Texaco (then McColl-Frontenac) together over a large part of Alberta and north-eastern British Columbia.[1] As shall be demonstrated, the network of exchanges at the refinery level also tied these and other companies together.

These joint operations or exchange agreements served the same purpose in each sector. In the production sector, agreements for participation in joint projects were entered into with the explicit understanding that this would result in a reduction in competition. Evidence of this is provided by statements that postulated that, as long as only the majors were participants in any area, then price stability could be maintained. For instance, the following excerpt from an Imperial document discusses how price stability would be accomplished if the majors alone maintained 'control' of any crude found in the Canadian north:

1. Appendix A describes this agreement in greater detail.

"If the producing companies are largely the majors, and if the control of the reserves remain in relatively few hands with the Federal Government as the only lessor, *the objective of price stability at a reasonably high level* will be more readily attainable and, as a consequence, the pressure for a greater share of the market will be reduced."

(Document # 109479, November, 1968 Imperial, emphasis added)[2]

Implicit in Imperial's attitude is the recognition that the majors' interdependence and self-interest would be sufficient to restrict the development of price competition. Again, in considering the need for official restrictions on production if new supplies were to be discovered in the Canadian north, Imperial commented that, if the major companies were to gain control of the discoveries, they could manage to restrict production on their own:

"The pressures which encourage governments to become heavily involved in inter-region proration will tend to be minimized if, as we now envisage the circumstances, the new supplies are concentrated in the hands of a relatively few, principally major, producing companies."

(Document # 109480, November, 1968, Imperial)[3]

Exchange agreements at the production level provided one of the methods used by the majors to reduce competition. For instance, in discussing what would happen to the price structure if large discoveries of crude occurred off eastern Canada, Imperial indicated that, if the majors controlled the discoveries, offshore exchanges could be arranged:

"Also it is quite possible that, if international companies are concerned and the discovery is of a medium size (l00-250 MB/D), crude exchanges could be arranged with offsets in other parts of the world."

(Document # 109753, February 5, 1969, Imperial)[4]

An exchange such as this would have reduced the price pressures that would otherwise develop in eastern Canada.

This provides evidence that the leading firm in the production sector in Canada understood that agreements at the production level could be so arranged as to reduce competition. Imperial was not the only company to argue this. Shell, in assessing a joint exploration venture with Gulf, felt such a joint arrangement would be desirable in order to reduce competition. The following excerpt indicates that Shell considered joining with Gulf in bidding for land so as to reduce the price that would be paid:

"No final commitment was made that we bid jointly with British American, but they are aware of our thinking on price. If we bid alone we would expect to have to bid somewhat higher for individual parcels to have a reasonable chance of getting the kind of representation we wish."

(Document #31661, January 14, 1966, Shell)[5]

As Shell recognized, its actions in joining with Gulf would "ease competition" (Document #31662).[6]

Imperial's statements emphasize that the leader in the production sector expected the joint operations of the majors to be able to suppress competition therein. The excerpts from the Shell document demonstrate that Shell intended to operate jointly with another major so as to reduce competition. That these agreements generally had their intended effect has already been outlined in the study of the production sector. There it was demonstrated that Mobil, one of the largest producers of crude oil in Canada, was tied to Imperial via a crude exchange agreement. This, Mobil recognized, meant that it could exercise little or no independent pricing action in Canada. Therefore it is apparent that joint arrangements in the production sector, akin to those implemented in refining, were both intended to and did interfere with competition.

Not only does the production sector demonstrate that agreements among the majors were used to restrict competition, but it also shows that the largest firms engaged in a type of market foreclosure that had the same effect. In the refining sector, Imperial felt it was important for the majors to 'control' refinery capacity to restrict supply to 'discount' marketers. When the majors invested in land in the production sector so as to foreclose the market to smaller firms they exhibited a similar policy to that which was followed in refining.

The financial resources of the majors were being used in the production sector to foreclose exploration opportunities as early as the mid-nineteen sixties. Imperial, in 1966, noted that much of the land in the Northwest Territories had been taken up and that the timing of its own acquisitions in "the Northwest Territories and Atlantic Offshore stemmed mainly from the forces of competition for control of land" (Document #106983).[7] Attempts to develop 'control' of crude, therefore, extended even to the exploration stage. That the majors used their financial resources to tie up large tracts to benefit from the exploration efforts of others is emphasized by Shell:

> "Past exploration has shown that the companies that maintain spreads of acreage in areas of possible new objectives often are able to capitalize on discoveries made by others."
>
> (Document #31345, February 21, 1966, Shell)[8]

That this philosophy was well understood by the majors when they entered into land exchanges with one another is borne out by a letter sent from Imperial to Mobil. In proposing a swap of acreage with Mobil, Imperial was careful to assure Mobil that it appreciated "Mobil's exploratory philosophy" and pointed out that its proposal would "allow Mobil to wait out Panarctic's results without spending much in the way of commitment dollars" (Document #17585).[9]

While this strategy could be adopted by the largest majors, this was not the case with smaller firms. For instance, Imperial noted, in 1966, that most land in the Northwest Territories was already controlled.

All of this suggests that the majors enjoyed a financial advantage which was used to develop 'control'. As shall be demonstrated a similar situation existed in the refining sector among the same firms.

While the production and the refining sectors bore important resemblances one to another in terms of the extent of inter-company cooperative agreements, the parallels between the refining and marketing sectors do not lie in the area of such explicit inter-firm agreements. Marketing, generally, did not have the type of joint ventures found in the production sector. Nor was it characterized by the same exchange of information that existed in the refining sector. Discussions that took place between firms at the marketing level were fewer and more directly related to matters inimical to the public interest. When British Petroleum discussed the need to eliminate free burner service in 1973 with other marketers, it was attempting to coordinate a general increase in the price of fuel oil (Document # 9167).[11] The marketing volume outlines a number of other communications aimed at explaining local pricing strategies to other companies. Discussions in the marketing sector such as these were more akin to those which related to the pricing mechanism in the production sector. In the volume devoted to the production sector, evidence was adduced to show that the majors organised joint efforts to restrict competition and discussed both the pricing structure and the coordination of production reductions.

To the extent that explicit discussions in marketing were used to coordinate policy, then marketing more closely resembled production than refining. However the parallel should not be given undue weight. In production, the discussions relating to prices and to production restrictions were a central part of the pricing mechanism. In marketing, the majors were able to implement a common set of disciplinary policies against the price competitive independent marketers without extensive discussions. That they were able to do so must be attributed to their ability to coordinate behaviour via tacit understandings rather than explicit arrangement. Inter-firm communications took place that tended to ensure that actions and policies taken against the independents would not be misinterpreted by other majors. The knowledge that was communicated served to assist the majors in coordinating their policies to achieve a common objective — restraining the independents and maintaining a high gasoline price structure. In this regard, the marketing sector was akin to the international

sector where discussions also served to ensure that similar policies would be followed but where the coordination of policy did not rely primarily upon these communications.

Nonetheless, the arrangements adopted in marketing and refining were related. The effectiveness of the predatory and disciplinary policies that were adopted in the marketing sector is testimony to the effectiveness of the anti-competitive effect of the arrangements reached in the refining sector. This does not mean that exchange and other related agreements, such as those found in the Canadian refining sector, must necessarily be detrimental to competition. As already stressed, they might have permitted the building of large scale refineries in order to fully exploit economies of scale without questionable secondary effects. The issue is whether, in arranging exchanges, the majors chose to go beyond what was necessary to exploit economies of scale; whether they used the agreements to restrict competition beyond what was necessarily incidental to the primary purpose. Evidence will show that, in the refining sector, policies were directed at restricting the independent marketer — just as they were in the marketing sector. That the stated intent and actions of the majors in the refining sector were supportive of their behaviour in the marketing sector indicates that the market power that arose from refinery ownership was exploited in a fashion that was inimical to the public interest.

Even though the existence and extent of inter-company arrangements at the refinery level facilitated the development of monopolistic conditions in the production and the marketing sector, the issue that must be addressed is whether, with the technology of industry, there could have been any other result; whether the relationships that developed among the refiners must necessarily have arisen if economies of scale were to be exploited at the refinery level. This inquiry will show that the majors adopted a set of arrangements that did more than just exploit the economies of scale that existed at the refining level. The particular form of arrangements that were adopted served to reduce competition both in this sector and others. Moreover, the majors' actions cannot be defended as necessary in order to have exploited economies of scale. It was not the act of exchanging product that had untoward results. It was the manner in which this was accomplished that served to reduce competition. To understand this, a parallel to the actions of the majors in the marketing sector can be drawn. In the marketing volume it is demonstrated that, when faced with their fellow firms adopting disciplinary policies against the independents, each of the majors chose that policy which best suited its own circumstances but which also reinforced those adopted by the others. In so doing, they intended to eliminate or to restrict those marketers who stimulated price competition. In the refining sector, it will be demonstrated that the majors acted in a similar fashion. When entering agreements one with another, they acted in such a way as to reinforce their mutual objectives, to maintain oligopoly discipline, and to reduce the

possibility of competition from those firms which, by their innovative marketing techniques, were attempting to inject price competition into the marketing sector.

Up to this point, the relationship between the refining and other sectors — both in terms of interactions, reinforcing effects, and similarity of behaviour — has been stressed. It should, however, be emphasized that there is a unique aspect to the refining sector. This is the conceptual framework required to analyze the effect of the arrangements made between firms in the refining sector. There are those who would argue that exchanges at the refinery level are advantageous to competition. Generally they contend that these arrangements stimulate entry and expand the number of firms in the marketing sector — that without exchanges, economies of scale are so great, that since only one or two refineries could exist, the industry would consist of a number of local monopolies or duopolies. While the issue that is being addressed by this argument — the extent to which entry is enhanced and performance improved — is appropriate, the conclusion that the exchanges must necessarily be beneficial is incorrect. An analysis of the effects of exchanges should be set within a framework that considers entry and the structure of the industry; but it should not assume what is being investigated. For it is not true that entry will be encouraged and independent competitive activity stimulated — irrespective of the type of exchange agreement that is implemented.

An adjudication of the effect of product exchanges must start with the recognition that the effect of entry will differ depending upon the identity of the entrant. In addition, it must recognize that, irrespective of the entrant's identity, an exchange may involve restrictions upon the entrant that prevents competition from developing. Models of dynamic oligopoly behaviour have been developed.[1] These models recognize that the action of blockading entry will not necessarily maximize profits. In these models, entry is anticipated and permitted by the leading firms, with the industry's price being held above competitive levels for long periods. However, these models generally do not specify what strategy will be adopted to reduce the rivalrous behaviour that might develop after entry. The study of the refining sector shows that agreements such as those used by the majors serve this purpose. For they join the interests of the new refiners with those of the original firms.

This study shows that, in order to reduce competition from entrants to the industry, three different strategies were adopted by the major refiners. The first strategy was implemented for refinery agreements among the majors themselves. Here, the general policy was to enter into exchange agreements with one another but to do so in such a way that the interests of each firm were

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1. See D. Gaskins Jr., "Dynamic Limit Pricing: Optimal Pricing under Threat of Entry", *Journal of Economic Theory*, New York: Academic Press Inc., (1971), pp. 206-322.

closely tied together — either across regions, or over time. The agreements, therefore, served to coordinate the interests of existing firms and to explain why monopolistic conditions developed at the marketing, the production, and the international level. A second strategy was followed with respect to requests for product from potential entrants to the refining sector. Here evidence shows that existing refiners would refuse to enter refinery agreements unless a definite commitment was made by the firm to build a new refinery.[1] When this occurred, agreements could be offered with the intent to 'control' and to restrict the firm that had just constructed a new refinery. The effect of these restrictions was not dissimilar to that which developed from refinery agreements among existing majors. These restrictions served to tie refiners' interests together and to avoid price competition in the marketing sector. A third strategy was adopted with respect to requests from marketers who posed little threat of entry to refining. In this case, the policy of the majors was generally to supply these firms only to the extent that they abided by the oligopoly's marketing methods. Preference was accorded to those in this group who did not discount heavily. Equally important, these firms, in approaching the majors, knew the importance of this criterion and emphasized it in their discussions with the refinery owner.

Each of these three strategies was devoted to obtaining a common end — preventing price competition in the marketing sector. Viewed as such, the arrangements adopted in the refining sector were not used to facilitate entry. Instead they were used to control the nature of competitive behaviour that usually accompanies entry.

The success of this policy in restraining competition cannot be measured by an examination of the refinery level alone. For one thing, vertical integration in the industry was so high that most transactions between this sector and marketing were inter-divisional transfers. Performance measures are, therefore, not readily available for this sector. Secondly, the mere fact that the identity of firms in this sector changed and that entry occurred cannot be used to infer that entry was so easy that competition must have prevailed. For the practices that were adopted in this sector were meant to restrict the beneficial effects of competition that usually accompany entry.

The effects of the arrangements reached in the refinery sector must be evaluated in terms of the ease with which they permitted the industry to restrict competition elsewhere. In the marketing sector, they adopted common policies, including temporary allowances, consignment and 'fighting brands', to discipline the independent firms. That they were successful in accomplishing the latter must be attributed not only to their success in consciously adopting similar policies in marketing but also to the inter-firm arrangements found in the

1. Product might be supplied but not on the advantageous terms associated with a refinery exchange or a processing agreement.

refining sector. Because the latter were aimed at the same objectives and because they facilitated the policies adopted in the marketing sector, the excessive wholesale and retail margins that were maintained in marketing are as much proof of the effectiveness of the arrangements reached in the refining sector as it is of the predatory tactics adopted by the majors in the marketing sector.

The following sections outline the structure of the refining sector and then detail the way in which the strategies were used by the major refiners to restrict competition in this and other sectors.

C. *The Structure of the Industry*

1. *Concentration in the Refining Industry*

Most inter-firm agreements at the refinery level were made between two or perhaps three firms. Yet, this was sufficient to create a comprehensive network of relationships among firms at this level. The reason for this lies in the high level of market concentration that existed in Canada and the similarity of participants in each of the regional markets. Very few pairwise linkages of firms were required before almost the complete system of firms and regions were joined together.

At both the refinery and the marketing levels, the industry was dominated by four firms with representation in all or all but one region. As Table 1 indicates, by the early nineteen seventies, Imperial and Gulf possessed refineries in all five regions — the Pacific, the Prairies, Ontario, Quebec, and the Maritimes. Shell and Texaco, the other two firms which marketed in all five regions, possessed refineries in four out of the five regions. The other refiners were concentrated regionally. Chevron, Pacific Petroleums, and Union were situated in the Pacific Region; Consumers' Co-operative and Husky were situated on the Prairies; Sun Oil and British Petroleum were located in Ontario; Golden Eagle, British Petroleum, and Petrofina owned refineries in Quebec; and Golden Eagle, Irving, and Newfoundland Refining possessed refineries in the Maritimes. Each region, therefore, possessed refineries belonging to at least three of the four national marketers. Except for the Prairies, each also had representation from what will be referred to as the regional majors — as defined below. However, the level of concentration and its trend in the post-war period has differed sufficiently region by region that the structure of each area needs to be examined separately.[1]

1. See Appendix B for a brief history of entry and exit from the industry during the post-war period.

TABLE 1

LOCATION OF REFINERIES BY COMPANY
(1974)

Company	*Pacific Region*	*Prairie Region*	*Ontario Region*	*Quebec Region*	*Maritime Region*
Imperial	X	X	X	X	X
Gulf	X	X	X	X	X
Shell	X	X	X	X	
Texaco		X	X	X	X
Chevron	X				
Pacific Petroleums	X				
Golden Eagle				X	X
British Petroleum			X	X	
Petrofina				X	
Sun			X		
Irving					X
Husky		X			
Union Oil of Canada	X				
Consumers' Co-Op		X			
Newfoundland Refining					X

Source: Financial Post Survey of Oils 1976.[13]

If the structure of the industry is to be described in an efficacious manner, some method must be chosen to summarize the wealth of information available on market participants. The problem that arises in the choice of summary statistics is that measures of structure, if mechanically manufactured, reveal little in the way of useful information. Ideally, the circumstances particular to each industry need to be considered when interpreting simple measures such as concentration ratios. This destroys much of the general usefulness of these measures in cross-sectional studies. However, in the case of a specific industry study such as this, substantial evidence on behaviour is available to guide the choice of summary measures of market structure. The marketing and the production volumes show that the industry may be divided into three groups according to commonality of interests, the extent of inter-firm communications, and the general tendency to adopt competitive or independent behaviour.

The first group contains the four major firms, subsidiaries of large international petroleum companies, which had national representation at the marketing level — Imperial, Gulf, Shell, and Texaco. These firms did not generally engage in price competition with one another; instead, they actively pursued a policy that served to coordinate their actions. Therefore, in what follows, one measure of structure will be presented that summarizes the percentage of refining capacity owned by these firms in any region. Since the

policies of these firms so closely resembled one another, no distinction is made as to whether one, two, three or all four firms were represented in an area. The only important piece of information is the total capacity owned by this group as a whole. This group is collectively referred to as the 'national majors'.

The second group consists of firms which were also subsidiaries of large international petroleum companies, but whose representation was restricted to only one or two regions in Canada. British Petroleum, Petrofina, Sun Oil, Chevron, and Irving fall into this category. This group is collectively referred to as the 'regional majors'. These firms really only differed from the first set with regard to the extent of their geographic representation. Their marketing policies were more akin to the national majors than to the non-integrated independent firms which were responsible for price competition in the marketing sector, referred to as 'independents'. Therefore the second measure that will be presented is the per cent of total capacity owned by both the 'national' and the 'regional' majors. Both groups together are collectively referred to as 'the majors'.

The remainder of refining capacity was owned by firms whose aggressiveness varied; however, most were somewhat more inclined to adopt a competitive stance in marketing than the majors.

(a) *The Maritime Market*

The Maritime market has been dominated throughout the post-war period by three of the national majors — Imperial, Texaco, and Gulf — and one large regional major, Irving. Prior to 1960, Imperial controlled 99 per cent of refining capacity. In 1960, the Irving refinery in New Brunswick was brought on stream. In 1965, Texaco constructed a refinery in Nova Scotia. In 1971, Gulf finished its own refinery in this province. Therefore, entry was primarily from both national and regional majors.[1] As Table 2 demonstrates, except for a brief period in the early nineteen seventies, the concentration ratio for these four firms as a group — the majors — shows they consistently controlled over 90 per cent of capacity.[2]

(b) *The Quebec Market*

Refining capacity in Quebec was concentrated in the hands of the four national majors until the early nineteen sixties. Table 3 shows that prior to

1. Golden Eagle, a firm which fell into the third category of more aggressive marketers, constructed a small refinery in Newfoundland in 1961.
2. Concentration was temporarily eroded by Newfoundland Refining which entered in 1973, only to suspend operations in 1976.

TABLE 2

CONCENTRATION OF REFINING CAPACITY IN THE MARITIMES

Year	*Principal Refiners*	*Total Capacity of Principal Refineries (barrels per day)*	*Total Maritime Refining Capacity (barrels per day)*	*Concentration Ratio of The Majors*
1956	Imperial	42,000	42,300	99.3%
1957	Imperial	44,000	44,300	99.3%
1960	Imperial Irving	96,500	96,800	99.7%
1961	Imperial Irving	97,500	106,300	91.7%
1965	Imperial Irving Texaco	117,000	125,500	93.2%
1970	Imperial Irving Texaco	122,100	125,100	90.4%
1971	Imperial Irving Texaco Gulf	294,300	280,300	95.2%
1973	Imperial Irving Texaco Gulf	300,000	414,000	72.5%
1975	Imperial Irving Texaco Gulf	301,800	415,800	72.6%
1976	Imperial Irving Texaco Gulf	432,000	446,000	96.9%

Source: Department of Energy, Mines and Resources, *Petroleum Refineries in Canada* various years.[14]

1960, Imperial, Gulf, Shell, and Texaco controlled over 90 per cent of capacity. Together with Petrofina, this group controlled 100 per cent of capacity at this time. With British Petroleum's entry in 1960, the national majors' share fell to about 80 per cent but these six majors together controlled 100 per cent of capacity. During the decade of the nineteen sixties, the national majors saw their share reduced from about 80 per cent to 70 per cent as Petrofina and British Petroleum expanded. However, the latter adopted essentially the same refining and marketing strategies as the national majors and cannot be considered to have been independent forces. The concentration ratio for these six

firms as a whole shows they still controlled 100 per cent of refining capacity by 1970.

In late 1971, Golden Eagle brought a 100,000 barrels per day refinery on stream. Golden Eagle, at least at this time, did not conform to the national majors' policies as much as did Petrofina and British Petroleum. The national majors' share of capacity decreased to 58 per cent but with Petrofina and British Petroleum, this group consisting of the national and two regional majors still controlled about 85 per cent of capacity in 1976.

(c) *The Ontario Region*

The post-war history of the Ontario market can be divided into two periods. During the first period, the percentage of the refining industry owned

TABLE 3

CONCENTRATION OF REFINING CAPACITY IN QUEBEC

Year	*Refiners*	*Total Capacity of National Majors'*[1] *Refineries (barrels per day)*	*Total Capacity of National Majors' & Regional Majors'*[2] *Refineries (barrels per day)*	*Total Quebec Refining Capacity (barrels per day)*	*4 Firm (National Majors) Concentration Ratio*	*5 and 6 Firm (National and Regional Majors) Concentration Ratio*
1956	Majors[1] Petrofina	227,000	247,000	247,000	91.9%	100%
1957	Majors[1] Petrofina	235,800	255,800	255,800	92.2%	100%
1960	Majors[1] Petrofina Brisith Petroleum	243,000	297,000	297,000	81.8%	100%
1965	Majors[1] Petrofina British Petroleum	260,700	328,700	328,700	79.3%	100%
1970	Majors[1] Petrofina British Petroleum	328,600	460,000	460,000	71.3%	100%
1971	Majors[1] Petrofina British Petroleum	339,500	477,500	577,500	58.8%	82.7%
1975	Majors[1] Petrofina British Petroleum	376,100	544,100	644,100	58.4%	84.5%
1976	Majors[1] Petrofina British Petroleum	377,800	545,800	645,800	58.5%	84.5%

Notes: 1. Imperial Oil, Texaco, Shell and Gulf.

2. Petrofina until 1957 and Petrofina and British Petroleum from 1960 onwards.

Source: Department of Energy, Mines and Resources, *Petroleum Refineries in Canada*, various years.[15]

by the national majors increased as smaller refiners were acquired or closed down. For instance, in the early nineteen fifties, Imperial and Gulf each had refineries and there were three other refineries in Ontario.[1] In 1957, Texaco acquired Regent Refining. In 1963, Shell acquired Canadian Oil. The third refinery which was owned by Husky and located in Fort William was closed in 1964. As a result, the four national majors controlled some 83 per cent of capacity by 1964 (see Table 4).

TABLE 4

CONCENTRATION OF REFINING CAPACITY IN ONTARIO

Year	*Refiners*	*Total Capacity of National Majors'[1] Refineries (barrels per day)*	*Total Capacity of National Majors' & Regional Majors'[2] Refineries (barrels per day)*	*Total Ontario Refining Capacity (barrels per day)*	*4 Firm (National Majors) Concentration Ratio*	*5 and 6 Firm (National and Regional Majors) Concentration Ratio*
1956	IOL, Gulf, Sun Oil	99,300	114,300	159,700	62.2%	71.6%
1957	IOL, Gulf, Texaco, Sun Oil	152,350	167,350	198,510	76.7%	84.3%
1960	IOL, Gulf, Texaco, Sun Oil	175,400	193,400	260,820	67.2%	74.2%
1963	Majors[1], Sun Oil	254,900	279,900	305,470	83.4%	91.6%
1964	Majors[1], Sun Oil, British Petroleum	254,900	306,900	306,900	83.1%	100%
1965	Majors[1], Sun Oil, British Petroleum	258,400	322,400	322,400	80.1%	100%
1970	Majors[1], Sun Oil, British Petroleum	318,200	389,200	389,200	81.8%	100%
1974	Majors[1], Sun Oil, British Petroleum	362,700	522,700	522,700	69.4%	100%
1975	Majors[1], Sun Oil, British Petroleum	378,800	540,300	540,300	70.1%	100%
1976	Majors[1], Sun Oil, British Petroleum	379,100	549,600	549,600	69.0%	100%

Notes: 1. Imperial Oil, Texaco, Shell and Gulf.

2. Sun Oil until 1963, Sun Oil and British Petroleum from 1964 onwards.

Source: Department of Energy, Mines and Resources, *Petroleum Refineries in Canada*, various years.[16]

1. The composition of the three varied. In 1956 it was Husky, Regent and Canadian Oil. On December 31, 1956, Texaco acquired Regent. In 1958 the Cities Service refinery came on stream. Thus, the three other refineries belonged to Cities Service, Husky and Canadian Oil by 1958.

Over the subsequent decade, the share of these four national majors decreased from 84 per cent to about 70 per cent with most of this occurring after 1970. This was the result of the expansion of the two regional majors. British Petroleum had entered in 1964 with its purchase of the Cities Service refinery. Sun Oil had a refinery in Ontario since the nineteen fifties. Both of these expanded relative to the national majors in the early nineteen seventies. However, as the marketing sector of this study demonstrates, Sun Oil and British Petroleum were not aggressive forces in the market. Between the national majors and these two regionals, 100 per cent of capacity was controlled from 1964 onward.

The parallel between Quebec and Ontario in this regard is straightforward. During the nineteen sixties, some six firms — four nationals and two regionals — controlled most of the refinery capacity in both regions. However, there was a difference. In Ontario, the refineries owned by firms such as Canadian Oil, Husky and Regent — firms which were not connected with large integrated internationals — disappeared at the beginning of the nineteen sixties and did not return. In Quebec, where independent refiners had not existed in the post-war period, entry occurred late in the period from such a firm — Golden Eagle.

(d) *The Prairie Region*

In the Prairies, concentration markedly increased since the nineteen fifties. Although the Prairies originally contained a number of small independent refiners, their number steadily decreased between 1956 and 1976. During this time, the four national majors increased their share from 63 per cent to 88 per cent of refinery capacity (See Table 5).

In 1956 and 1957, three of the national majors operated refineries in the Prairies — Imperial, Gulf and Texaco. While these refiners owned only nine of the twenty-four refineries, they accounted for 63 per cent of total refining capacity. In 1960, the fourth national major, Shell, entered the refining sector via its acquisition of North Star Oil Limited. With its entry, the national majors' control of capacity rose to 75 per cent.[1]

During the subsequent period the national majors' share increased as they acquired additional firms. In December of 1962, Gulf acquired Royalite.

1. Five small refineries were shut down in 1958 and 1959: a 950 barrels per day plant in Prince Albert, Saskatchewan owned by Prince Albert Refineries a 1,000 barrels per day plant in Bonnyville, Alberta owned by Bonnyville Oil Refineries, a 1,100 barrels per day plant in Moose Jaw, Saskatchewan owned by Petroleum Fuels Limited and two plants owned by Royalite Oil Company Limited — a 950 barrels per day plant in Prince Albert, Saskatchewan and a 4,750 barrels per day refinery in Coleville, Saskatchewan.

In March of 1963, Shell acquired Canadian Oil. By 1976, only nine refineries were still in operation and seven of these were owned by the national majors. In comparison, the national majors had only 9 of the 24 refineries operating on the Prairies in 1956. The only two refineries not owned by the national majors in 1976 were owned by Consumers' Co-operative and Husky Oil. Thus the four national majors owned 89 per cent of total capacity by 1976.

As in Ontario, the Prairies experienced a reduction in the independent sector and an increase in the per cent of capacity owned by the national majors. However, contrary to Ontario, the regional majors did not play an important role. The structure of the refinery sector in this region most favoured the development of monopolistic control upon the part of the national majors.

TABLE 5

CONCENTRATION OF REFINING CAPACITY IN PRAIRIES REGION

Year	*Major Refiners*	*Total Capacity of National Majors' Refineries (barrels per day)*	*Total Prairies Refining Capacity (barrels per day)*	*4 Firm (National Majors) Concentration Ratio*	*Number of Operating Refineries*	*Number of Refineries Operated by National Majors*
1956	Imperial Gulf[1] Texaco	114,050	179,500	63.5%	24	9
1957	Imperial Gulf Texaco	118,270	187,735	63.0%	24	9
1960	Imperial Gulf Texaco Shell	146,120	195,440	74.8%	20	11
1963	All National Majors	168,020	199,230	84.3%	17	13
1965	All National Majors	172,850	204,250	84.6%	16	12
1970	All National Majors	206,150	238,850	86.3%	15	11
1971	All National Majors	254,700	285,900	89.1%	13	10
1975	All National Majors	290,200	329,900	88.0%	10	7
1976	All National Majors	301,500	340,000	88.7%	9	7

Note: 1. In 1950, Gulf acquired 77.37% of Anglo-Canadian Oils Limited; thus, Gulf refining capacity includes refining capacity of Anglo-Canadian Oils Limited.

Source: Department of Energy, Mines and Resources, *Petroleum Refineries in Canada*, various years.[17]

(e) *The Pacific Region*

The Pacific Region has seen the highest level of concentration for the majors of any region except the Maritimes. Imperial, Shell and a regional major— Chevron — controlled 90 per cent of capacity in 1956 (see Table 6). In 1958, Gulf entered the market and the group of national and regional majors' share of total refinery capacity stood at 90 per cent as of 1960. Despite subsequent entry by Pacific Petroleums and Union Oil,[1] expansion by the majors and the acquisition of Royalite by Gulf[2] left the share of the three national majors and the regional majors relatively unchanged at around 86 per cent until the end of the period. In this respect, the Pacific region exhibited similar characteristics to the Maritimes. Except for the fact that Shell rather than Texaco was represented in the Pacific region, four international majors[3] controlled close to 90 per cent of capacity in both areas throughout the period.

TABLE 6

CONCENTRATION OF REFINING CAPACITY IN PACIFIC REGION

Year	*Principal Refiners*	*Total Capacity of Principal Refineries (barrels per day)*	*Total B.C. Refining Capacity (barrels per day)*	*Concentration Ratio for the Majors*	*Number of Operating Refineries*	*Number of Refineries Operated by the Majors*
1956	IOL, Shell, Chevron	63,500	70,250	90.4%	5	3
1957	IOL, Shell, Chevron	67,500	74,250	90.9%	5	3
1960	IOL, Shell, Chevron, Gulf	89,000	98,700	90.2%	7	4
1965	IOL, Shell, Chevron, Gulf	93,900	100,400	93.5%	6	5
1970	IOL, Shell, Chevron, Gulf	107,400	125,800	85.4%	7	5
1975	IOL, Shell, Chevron, Gulf	128,100	150,100	85.3%	7	5
1976	IOL, Shell, Chevron, Gulf	141,900	163,900	86.6%	7	5

Source: Department of Energy, Mines and Resources, *Petroleum Refineries in Canada*, various years.[18]

1. Pacific acquired a small refinery of X-L Refineries in 1958, and subsequently constructed a plant at Taylor in 1960. Union constructed a refinery at Prince George in 1967.
2. Gulf acquired Royalite in 1962.
3. Exxon, Gulf, and Standard Oil of California participated in both regions — Standard via Chevron on the west coast and Irving on the east coast.

(f) *Summary*

While the degree of concentration in the petroleum refining industry varied by region, there is no indication that it markedly decreased. On the east and west coasts, where three of the national majors and one regional dominated the industry, concentration remained high. On the east coast, the share accounted for by the majors exceeded 90 per cent after 1957—with the exception only of a brief period in the early nineteen seventies; on the west coast, the share accounted for by the majors exceeded 90 per cent until the late nineteen sixties. In the early nineteen seventies, it still remained at about 85 per cent.

On the Prairies, the share of the four national majors continuously increased throughout the period. Starting at a level of 64 per cent in the mid-nineteen fifties, it reached almost 90 per cent by 1976. Like the Prairies, Ontario also saw the four national majors starting from a level of about 62 per cent in the mid-nineteen fifties and increasing to about 83 per cent in the early nineteen sixties. However, contrary to the Prairies, this trend did not continue. In Ontario, the national majors shared subsequent expansion with two large regionals — British Petroleum and Sun Oil. Together these six firms accounted for 100 per cent of capacity in Ontario throughout the late nineteen sixties and early nineteen seventies.

Quebec was the only province where this pattern was broken. Here the national majors started at a high level of around 90 per cent in 1956 and then consistently gave up market share. At first, this was to Petrofina and British Petroleum. However, the behaviour of both these firms in the marketing sector suggests neither should be classified as independent entities. Therefore, the effect of entry was to include two regional majors along with the national majors. This situation changed in the early nineteen seventies with the entry of Golden Eagle — a firm with less well-developed links to the others. However, even with entry from Golden Eagle, the six major refineries still controlled about 85 per cent of capacity by 1976.

In summary, the similarities in market structure of the refining sector across regions were much greater than the differences. Generally, those firms which resembled one another in integration, international connections, and behaviour controlled between 80 per cent and 100 per cent of capacity. The main differences in structure that occurred can be found in the extent to which this group consisted of only the four national brand majors, three of these four and a regional, or all four as well as two regionals. These differences in structure, given the basic similarities among these companies, should be regarded as relatively insignificant.

2. *The Pattern of Refinery Linkages*

Measures of industry concentration are aimed at ascertaining the extent to which so few firms exist that non-rivalrous behaviour may result. In

and by themselves, however, they are particularly unsuited to this task as the literature that has striven unsuccessfully to ascertain the 'critical' concentration ratio demonstrates.[1] Fortunately an evaluation of the extent to which the structure of this industry might be described as 'concentrated' and the way in which this might be appropriately summarized need not be pursued in a vacuum. The evidence adduced as to the similarity of action by the majors in the marketing sector justifies their being grouped together in the previous section. In addition, the extent and the nature of the agreements among refiners illustrates how intertwined the interests of these firms actually were. Indeed, this data is more revealing than simple concentration ratios *per se*.

Subsequent sections deal with the intent and purpose of the agreements reached in the refining sector. It is the extent, pattern and nature of these agreements that is examined here. Several patterns are revealed. First, the refining sector resembled the production sector. In production Imperial predominated, while Gulf can be said to have headed a second group during their dealings with Imperial. In refining Imperial also predominated. Gulf followed Imperial in terms of its extensive representation across the country, but it had more complex ties with other national majors. This parallel between these two sectors is not surprising. For its existence at one level tended to contribute to its emergence at the other. The pattern of refinery agreements indicates that a number of pairwise arrangements were made between the same companies across different Canadian regions. A web of connections is revealed which, when traced in their entirety from region to region and from company to company, linked the set of national and regional majors together across the entire country.

The arrangements between the majors can be grouped into those which were of short duration and those which were of longer term. The former might not even be covered by a written agreement. Refinery shutdowns, or other problems of a short term nature, resulted in firms supplying each other during these temporary breakdowns. Yet, even here, the relationships which developed illustrate that the majors appreciated their interdependence. An example of this is provided by the following excerpt from a Shell document. In it, a recommendation is made by a Shell official to supply Imperial, even though the direct costs of such an action made it unprofitable, in hope of building up goodwill between Shell and Imperial:

> "The decision to lend the fuel was done in the interest of good relations with our competitors, to prevent high cost support of their position in the hope that when the shoe is on the other foot we shall receive the same type of treatment.
>
> "As a matter of interest, Imperial's Edmonton T. & S. Department are writing a letter to their Head Office pointing out our attitude and our co-operation in

1. See L. Weiss, "Quantitative Studies of Industrial Organization", in M. Intriligator, *Frontiers of Quantitative Economics*, Amsterdam: North-Holland, 1971, pp. 371-5.

preventing high freight cost coverage of shortages, and requesting that when Shell approach Imperial under similar circumstances we be given the same co-operation and consideration.

"We have been striving to build this image and would not like to see it fall apart for the sake of 5,000 barrels which we know we can have returned to us if required,. . .

"We also felt since there are only two refineries in Winnipeg as long as one has any fuel we should help each other out to get over a tough winter."

(Document #26286, March 15, 1965, Shell)[19]

While there was nothing untoward about the relationship exhibited here, it does illustrate the natural interdependence that developed among firms at this level. Other examples show that an analogous type of cooperation developed between other companies. Gulf documents provide evidence of similar cooperation between itself and Imperial:

"Mr. Reeves reported that Clarkson [a Gulf refinery] was currently full of gasoline and that a crude cutback might be necessary if liftings did not increase. Mr. Wright indicated that a time exchange with Imperial was being arranged to solve the problem."

(Document #66391, May 24, 1973, Gulf)[20]

Of course, the need for and the existence of various types of inter-firm aid meant that refiners were in a position to retaliate against aggressive or uncooperative behaviour by their competitors. That this was done where one firm had deviated from oligopoly policy with regard to price competition is illustrated by events in 1971. Gulf was having difficulty in fulfilling a contract at Toronto's Malton Airport because of construction delays and approached Imperial for an exchange. Imperial felt it should be uncooperative because Gulf had been "aggressive price-wise" in obtaining the contract. The following excerpts outline Imperial's reasoning:

"Yesterday, Gulf approached Chuck Irvine and requested Imperial to supply 60MB of Turbo Fuel in January and February of 1972 at Malton. The reason for this request was not clear but we feel that it may be because the pipeline to the Malton Terminal will not be completed by year end.

. . .

"Roger Hamel of Marketing feels that we should advise Gulf that we will not supply *them* but will stand ready to supply Air Canada in case Gulf cannot supply. *He would like us to advise Gulf that because of the competitive nature of this bid we cannot, for marketing reasons, assist them in performing their contract.*

"Roger feels this way for four reasons. He would like Gulf to realise some of the risks involved in taking on Air Canada business, *so that they may not be as aggresive price-wise next time.*

. . .

> "While Logistics appreciates the concerns of the Marketing Department we feel there are some advantages to making a quote to Gulf at a price at least as high as our bid to Air Canada. First, there is the possibility of making the sale and thereby a profit . . ..
>
> "Secondly, if we do not supply, Gulf might give us trouble in another area where they are currently helping us out.
>
> "*Thirdly, by bidding high, we can get the price message to Gulf.*"
>
> (Document #123345-6, November 16, 1971, Imperial, single emphasis added)[21]

Short term exchanges or similar arrangements were, therefore, not just passive instruments. They served to weld the interests of the refiners together.

The second type of arrangement that served this purpose were longer term agreements.[1] Because of their size and duration, they were more important in linking the majors together at the refinery level than the localized exchanges discussed above. The latter type of exchanges may have engendered interdependence in local situations; however, longer term inter-regional agreements established a mutuality of interest so important that it had ramifications beyond the refining level extending into the marketing sector.

The pattern of the longer term linkages that developed at the refining level was not static. It varied as the identity of the firm with excess capacity arising from a refinery expansion changed. Nevertheless, a general pattern can be observed from an analysis of a recent period. Pairwise arrangements linked the majors from one end of the country to the other. Not every refinery was linked with every other. But then such a pattern was not a necessary condition for the establishment of interdependence. As long as the linkages extended in an unbroken line across the system, each firm could know that any aggressive action that it might initiate was likely to result in an escalation of reactions from others.

The tendency to engage in price competition in any industry is reduced as a firm's marginal demand curve approaches the industry demand curve. While a direct link at the refinery level among all firms guarantees that no firm will regard its demand curve as having any greater elasticity than that of the industry, indirect linkages have the same effect if each company fully comprehends the existence and effects of these linkages. As such, the extent of the anti-competitive effect of the agreements is, in one sense, a question of perception. The following excerpt shows Gulf's perception of the domino effect

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1. These agreements were sometimes more formal than short-term swaps in that they generally involved written agreements. Even so not all agreements were signed. On at least one occasion, a longer term exchange was arranged with only a general outline having been exchanged and no signatures attached. This degree of informality illustrates the extent of mutual interdependence and trust that existed among the major refiners and helps to explain why the group as a whole was able to adopt mutually reinforcing predatory marketing policies aimed at the independent sector.

that would result from any aggressive action on its part. In 1971, Gulf discussed the reaction Imperial might adopt should Gulf compete with Imperial for the United Farmers of Alberta (UFA) account. Gulf noted:

> "It is possible that Imperial might attempt to regain this volume through extremely aggressive price tactics, particularly in the industrial class of trade."
>
> (Document #60239, March 16, 1971, Gulf)[22]

Equally important was the recognition that other firms would follow Imperial in retaliating:

> "In addition, such aggressive pricing by Imperial would lead to retaliation by others, thus depressing the profitability of the entire market."
>
> (Document #60248, March 16, 1971, Gulf)[23]

Of course, interdependence such as this must be expected in highly concentrated oligopolies. This observation, therefore, in that it emphasizes this interdependence, provides evidence that this industry did act as a tightly knit oligopoly. While Gulf's observation does not show that the linkages between regions and companies exacerbated this situation, that it did so may be logically deduced from the perceived interdependence that existed between companies and the way in which the exchanges linked companies and regions together. Because of the pattern that developed in these linkages, an outbreak of local competition could be quickly spread from one area to another. Retaliation across regions was facilitated by the linkages that developed between refineries in different regions. Shell discusses this possibility in the following excerpt taken from a discussion of a Shell-Imperial agreement on an exchange between Montreal and the Maritimes. Shell noted that if it entered the aviation fuel market in the Maritimes, Imperial would "invite retaliation" elsewhere:

> "*Inclusion of Jet Fuel* — It was agreed that the negotiators should request the inclusion of Jet B (JP-4) and Jet A-1. Product Supply Planning will obtain product specifications from Manufacturing. Supply Planning will ask Marketing if they wish Jet Fuel included. *Since our A.M. meeting of May 19th it was pointed out that Imperial have all the jet business in the Maritimes now and for us to gain an account would mean taking it from Imperial. This could invite retaliation in other aviation markets.*"
>
> (Document #23954, May 19, 1971, Shell, latter emphasis added)[24]

In evaluating the pattern of linkages that developed among the majors, it is necessary to choose a criterion by which the importance of a flow can be determined. Relatively small flows are usually the result of short-term exchanges. As important as these may have been in contributing to a mutuality of interest within the industry, they played a secondary role in comparison to the major long-term exchanges that forged the strongest bonds between refinery owners. While this distinction is relatively clear, at least in concept, its

application is more difficult in practice. What determines a large as opposed to an insignificant flow in this context is the extent to which the linkage served to bind the interests of the two parties together. The greater is the percentage of a company's total supply that originates from others, or the greater is the percentage of refinery production that was shipped to third parties, the greater will be the dependency of one company upon others. However, there is probably no single positive number that defines the threshold below which the degree of interdependence is unimportant. Therefore, the analysis proceeds by examining whether alternate specifications of the degree of interlinkages affects the pattern of interdependence that is observed.

Tables 7 and 8 summarize the receipts and shipments of motor gasoline between the majors in each Canadian region as a percentage of each company's total receipts or total shipments of gasoline in that region. Motor gasoline is chosen because it provides the focus of the marketing sector. Entries where the amount of product shipped from one company to another amounted to less than 1 per cent of the total have been left blank. Table 7 presents the data for the year 1970. Table 8 presents the data for the year 1974.

The evidence presented in Tables 7 and 8 shows that the number of links via product shipments among the majors was substantial. Imperial was linked to Shell; Shell to Gulf and Texaco; and Gulf and Texaco to one another. There did not exist any national major outside of this network of relationships. In order to illustrate this network of linkages better, Figures 1 and 2 present a picture of the way in which the firms were tied to one another. Figure 1 does this for the year 1970, Figure 2 for the year 1974. In each figure, there are three diagrams. The first represents all links where the flow accounted for more than 10 per cent of the shipments or of the receipts of one of the two companies involved.[1] The second represents the links where the flows accounted for more than 5 per cent of the total and the third where the flows accounted for more than 1 per cent. The three diagrams taken together provide a sensitivity test of the importance of the criterion used to measure the existance of linkages between companies.

Figure 1 shows that, in 1970, the pattern of relationships is essentially the same — whether the 10, the 5, or the 1 per cent criterion is used. Shell is linked on one side to Imperial and on the other to Gulf and Texaco. As the flows accounting for a smaller percentage are added, the primary linkages expand in number and reinforce this picture. Only at the lowest level are links established between Texaco and Imperial or expanded between Gulf and Texaco.

Figure 2 shows that the pattern of relationships in 1974 resembles that of 1970 only when flows of greater than 10 per cent are considered. Once again,

1. Where a flow falls into two categories, i.e., greater than 10 per cent for one company, less than 10 per cent for the other, it is included in the larger of the two.

Imperial is linked to the other firms, as it were, through Shell. However, even at this level, the linkages among Shell, Texaco, and Gulf are more equally distributed in 1974 than in 1970. As flows of lesser importance are added, the separation between the two groups seen in Figure 1 — Imperial on one side, Shell, Gulf, and Texaco on the other — disappears. When all flows at the 1 per cent level are included, no direct link is missing. Each national major is tied directly to the others.

This change from a pattern of indirect linkages between the complete set of national majors to one where direct linkages developed between each member of the set is illustrative of a gradual increase in the degree of interdependence among the national majors. As early as 1971, a Vice-President

TABLE 7

PERCENTAGE OF SHIPMENTS AND RECEIPTS ACCOUNTED FOR BY INTER-COMPANY EXCHANGES, PURCHASE/SALE OR PROCESSING AGREEMENTS BY COMPANY AND BY REGION. (1970)
(%)

	Imperial		*Shell*		*Gulf*		*Texaco*	
	To	*From*	*To*	*From*	*To*	*From*	*To*	*From*
Imperial								
Maritimes			17.6	(—)	—	(—)	—	(—)
Quebec			—	(10.4)	—	(—)	—	(—)
Ontario			—	(—)	—	(—)	1.3	(1.2)
Prairies			9.8	(—)	—	(—)	—	(—)
Pacific			—	(—)	—	(—)	—	(—)
Shell								
Maritimes	9.8	(11.3)			1.6	(2.1)	—	(—)
Central	—	(—)			6.3	(1.6)	6.5	(—)
Western[1]	—	(9.7)			12.7	(11.5)	13.5	(4.2)
Gulf								
Maritimes	—	(—)	—	(—)			—	(—)
Quebec	—	(—)	2.0	(3.0)			—	(1.5)
Ontario	—	(—)	2.5	(13.6)			—	(—)
Prairies	—	(—)	6.4	(15.5)			3.0	(—)
Pacific	—	(—)	15.8	(1.8)			3.2	(—)
Texaco								
Maritimes	—	(—)	—	(—)	—	(—)		
Quebec	—	(—)	7.6	(—)	1.2	(—)		
Ontario	1.3	(1.6)	—	(8.2)	—	(—)		
Prairies	—	(—)	9.7	(9.7)	1.2	(4.8)		
Pacific	—	(—)	—	(63.5)	—	(12.9)		

Note: 1. Shell's Western region included what has been referred to here as the Prairies and the Pacific regions.

of Imperial noted that the industry was gradually moving towards an "'industry refinery' approach" (Document #111864).[27] The pattern that is revealed in Figures 1 and 2 confirms this.

While this trend is not without interest, it is not as significant as the fact that, even in 1970, the links between the national majors were so extensive as to provide an unbroken connection across the complete set. The linkage among these firms was such that interdependence would have been engendered between the complete set — albeit indirectly. Therefore the pattern of refinery linkages helps to explain why the majors acted as if their interests were coincident downstream in marketing.

TABLE 8

PERCENTAGE OF SHIPMENTS AND RECEIPTS ACCOUNTED FOR BY INTER-COMPANY EXCHANGES, PURCHASE/SALE OR PROCESSING AGREEMENTS BY COMPANY AND BY REGION. (1974)
(%)

	Imperial		*Shell*		*Gulf*		*Texaco*	
	To	*From*	*To*	*From*	*To*	*From*	*To*	*From*
Imperial								
Maritimes			15.3	(—)	—	(—)	1.6	(1.4)
Quebec			—	(13.4)	—	(—)	1.4	(1.7)
Ontario			—	(1.1)	—	(—)	5.3	(—)
Prairies			1.2	(—)	2.9	(2.2)	—	(—)
Pacific			—	(—)	—	(—)	—	(—)
Shell								
Maritimes	14.8	(11.8)			—	(—)	—	(—)
Central	1.1	(—)			8.8	(—)	1.6	(—)
Western[1]	—	(1.3)			13.8	(19.1)	7.7	(8.0)
Gulf								
Maritimes	—	(—)	—	(—)			4.5	(5.7)
Quebec	—	(1.5)	—	(—)			1.3	(1.0)
Ontario	—	(—)	—	(14.2)			—	(—)
Prairies	2.1	(2.8)	13.1	(12.4)			10.5	(6.8)
Pacific	—	(—)	7.4	(—)			12.8	(—)
Texaco								
Maritimes	3.2	(6.64)	—	(—)	6.4	(4.7)		
Quebec	1.2	(—)	—	(—)	—	(—)		
Ontario	—	(8.71)	—	(2.1)	—	(—)		
Prairies	—	(—)	12.6	(13.5)	13.8	(22.2)		
Pacific	—	(—)	—	(1.1)	—	(64.4)		

Note: 1. Shell's Western region included what has been referred to here as the Prairies and the Pacific regions.

It is not just the pattern of linkages between the majors that is important. It was argued earlier that some types of agreements would be more effective than others in discouraging independent activity and in diminishing competition. In particular, a reciprocal arrangement serves not only to establish a dependent relationship — as would any other supply arrangement — but it also can allow aggressive behaviour on the part of one party to be met immediately by the other. It can, therefore, be described as an effective disciplinary tool.[1] Thus it is important to obtain some idea of the extent to which the product flows between the majors can be classified as reciprocal agreements.

In Figures 1 and 2, intercompany product flows that are part of a reciprocal exchange of product either within one region or between two regions have been designated by an arrow identified with an "R". Table 9 summarizes the importance of reciprocal arrangements in each of the years 1970 and 1974. Several observations are relevant. First, in both 1970 and 1974, at least 45 per cent of the linkages shown on Figures 1 and 2 represented a reciprocal exchange of product.

Secondly, while over 45 per cent of the product flows represented reciprocal agreements in both years, the percentage was greater in 1974 as compared to 1970. Finally, in both years, the proportion of agreements that can be classified as reciprocal decreases as less important flows are added. For instance, in 1974, 80 per cent of the product flows that accounted for more than 10 per cent of the shipments or receipts of one company represented a reciprocal arrangement; however, in the same year, only 66.7 per cent of the product flows

TABLE 9

PROPORTIONS OF FLOWS THAT REFLECTED
A RECIPROCAL SUPPLY ARRANGEMENT

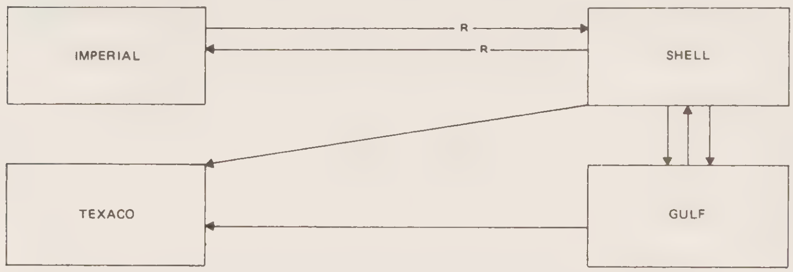
Category	*1970*	*1974*
Flows accounting for more than 10% of shipments or receipts	57.1%	80.0%
Flows accounting for more than 5% of shipments or receipts	46.2%	75.0%
Flows accounting for more than 1% of shipments or receipts	45.0%	66.7%

1. See D.K. Osborne, "Cartel Problems." *American Economic Review*, Nashville, Tennessee: American Economic Association, (December 1976) pp. 885-844 for an analysis of the importance of being able to react to sales changes of competitors via the use of a market share rule in order to maintain oligopoly discipline. It was argued earlier that reciprocity can be regarded as a market sharing arrangement.

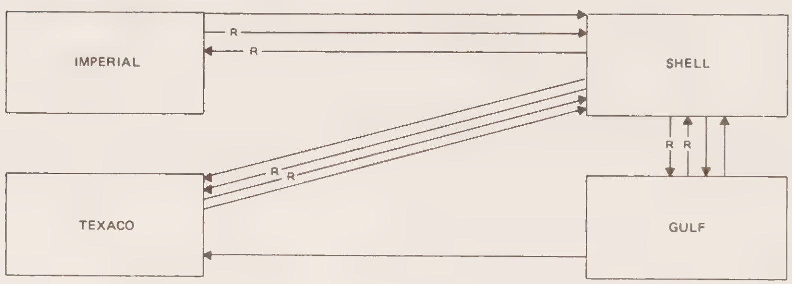
FIGURE 1

DIAGRAM OF LINKS BETWEEN THE MAJORS
(1970)

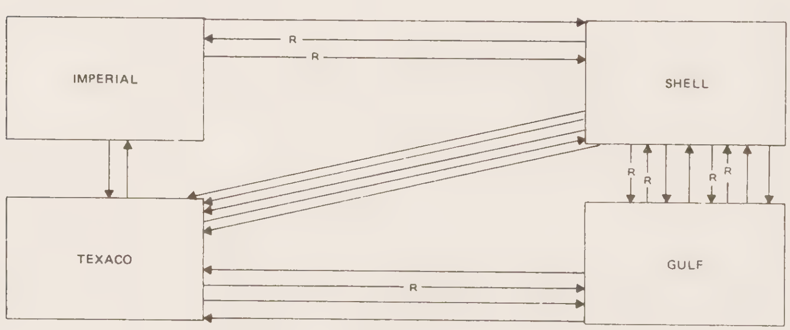
A) FLOWS ACCOUNTING FOR MORE THAN 10 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



B) FLOWS ACCOUNTING FOR MORE THAN 5 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



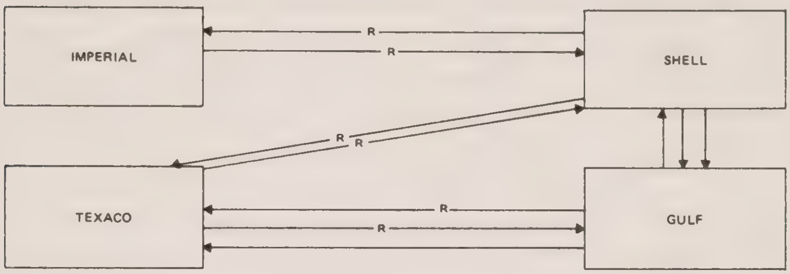
C) FLOWS ACCOUNTING FOR MORE THAN 2 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



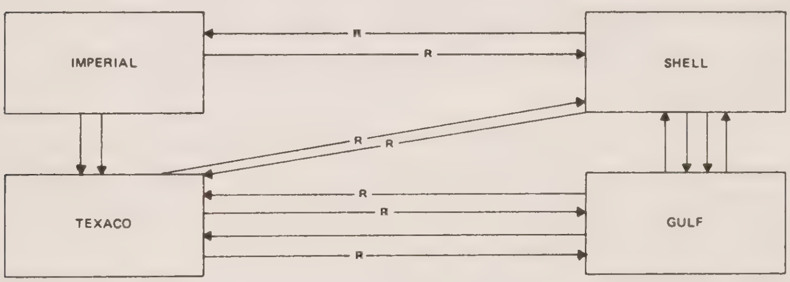
Source: Table 7

FIGURE 2
DIAGRAM OF LINKS BETWEEN THE MAJORS
(1974)

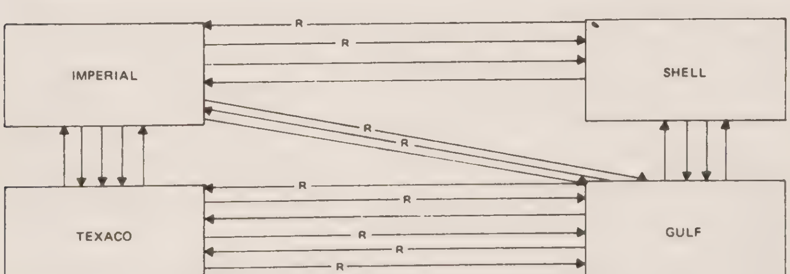
A) FLOWS ACCOUNTING FOR MORE THAN 10 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



B) FLOWS ACCOUNTING FOR MORE THAN 5 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



C) FLOWS ACCOUNTING FOR MORE THAN 1 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY.



Source: Table 8

which accounted for more than 1 per cent of the shipments or receipts from one company represented a reciprocal agreement. Thus, larger shipments tended more frequently to be reciprocal than did smaller shipments. This indicates that the four national majors maintained more control over the large exchanges — those that had the greatest potential for disrupting downstream markets. In summary, not only were the linkages between the national majors extensive and expanding in scope in the early nineteen seventies, but also the extent to which reciprocal arrangements were used was increasing during this period.

The national majors were, of course, not the only refiners in Canada. Therefore an analysis of the extent to which refinery exchanges and other agreements served to link the whole industry together at this level would be incomplete without an appreciation of the extent to which the other refiners were tied to the national majors. Figures 3 A) and 3 B) illustrate the nature of these linkages for 1974. The first figure shows that if only the flows that accounted for more than 10 per cent of shipments or receipts are considered, then each of the national majors was tied to four or five regional refiners. The second figure shows that when the criterion is dropped to 5 per cent, the number of linkages increase but their pattern does not change dramatically. In neither case is one national major a predominant leader in participating in exchanges with regional refiners, although Imperial and Gulf with their greater country-wide representation appear to be slightly more active than Shell and Texaco. All of the regional refiners are linked to at least one national major and, in some cases, to three or four.

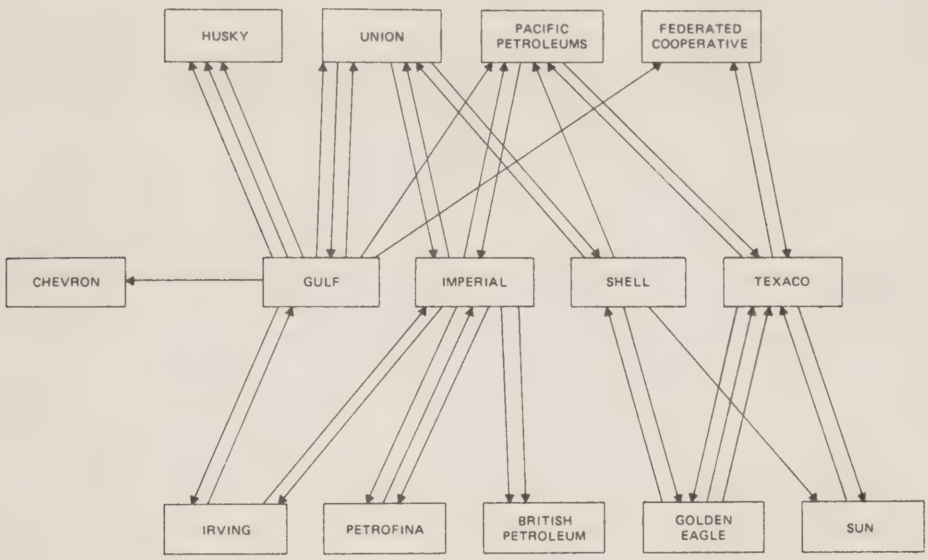
It should be noted that not only were the regional refiners linked to the national majors but also that they were, in a sense, more dependent upon the national majors than vice versa. In the majority of cases, the flow fell in the 10 per cent or 5 per cent category not because it made up that percentage of receipts or shipments for the national major but because it did so for the regional. Of course, these figures are based on the previously defined refining/marketing regions and in specific submarkets the reliance of the national major on the regional refiner could be quite high. For instance, Imperial data indicates that, in 1971 and 1972 respectively, Imperial only obtained 2.9 per cent and .6 per cent of its mogas supply in Quebec from Golden Eagle. However, Imperial recognized that for the area of Quebec City, Chicoutimi, Rimouski and surrounding areas, it would obtain about 20 per cent of its supply from Golden Eagle (Document # 113026-7).[29] Of course, what was true for Imperial would have been equally true for Golden Eagle and, therefore, the relative dependence of these two companies would generally remain unchanged if the market definitions chosen here were disaggregated.

Finally, it should be emphasized that many of the flows between the majors and the regionals were reciprocal in nature. Table 10 shows that in 1974 the reciprocal arrangements accounted for the majority of flows depicted in

FIGURE 3

DIAGRAM OF LINKS BETWEEN THE MAJORS
AND THE OTHER REFINERS
(1974)

A) FLOWS ACCOUNTING FOR MORE THAN 10 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY



B) FLOWS ACCOUNTING FOR MORE THAN 5 PER CENT OF SHIPMENTS OR RECEIPTS FOR ONE COMPANY

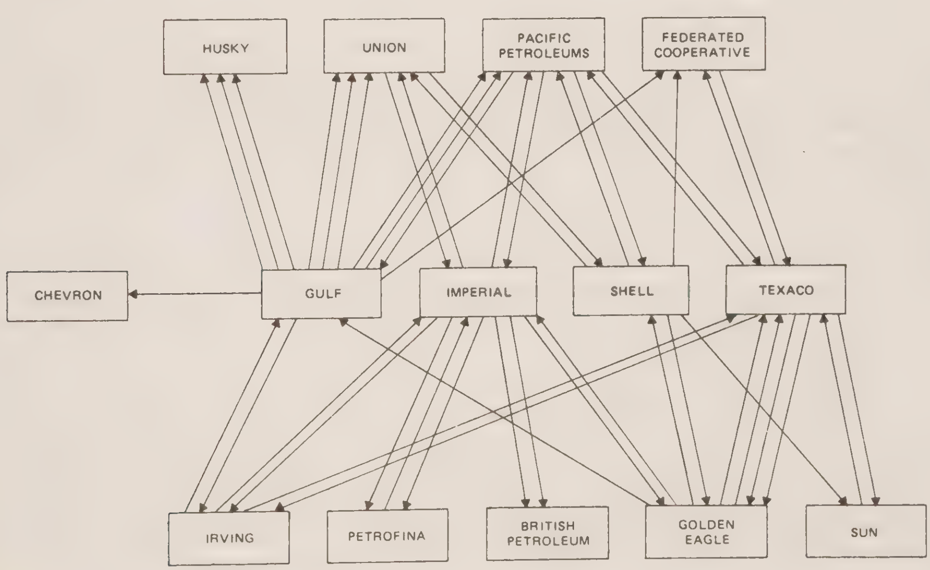


Figure 3 between Imperial, or Shell and the regionals. For Gulf and Texaco, the proportion varied from 32 per cent to 50 per cent. Once again, the national majors possessed a tool that could be readily employed against a firm which became too aggressive downstream in the marketing sector.

TABLE 10

PROPORTION OF FLOWS BETWEEN EACH NATIONAL MAJOR AND OTHER REFINERS THAT REFLECT A RECIPROCAL SUPPLY ARRANGEMENT (1974)

	Flows Accounting For More Than		
Company	*10%*	*5%*	*1%*
Imperial	55	62	55
Gulf	36	43	32
Shell	67	63	62
Texaco	33	50	47

This summary of inter-company linkages at the refining sector reinforces the impression yielded by the analysis of simple concentration ratios. Not only were there relatively few firms possessing refineries in each regional market but these firms were closely tied one to another. The resulting interdependence would, therefore, have been even greater than an examination of the simple concentration figures would suggest. Together the level of concentration and the extent of inter-refinery agreements served to bring together the participants in the refining sector. In turn, the nature of the inter-refinery agreements served to weld the separate refiners into a unit with the potential to exploit its monopoly power. The way in which these refinery arrangements were used to bind the separate majors together and the manner in which they were used to entrench their position against outsiders is dealt with in succeeding sections.

D. *The Organization of Refinery Linkages*

1. *Introduction*

The previous section illustrates the extent to which the industry participants were linked one to another at the refining level. As has been recognized, exchanges or sales of product can be used for constructive purposes — to take advantage of economies of scale at the refining level; but they also may be used to reduce competition. In this section, it will be demonstrated

that the national and regional majors deliberately arranged their supply agreements so as to maintain discipline and to restrain competition in the industry. It was not the act of supplying one another with product but the actual arrangements accompanying the exchanges that were meant to suppress competition. The anti-competitive arrangements encompassed such things as exchanges of information as to competitive plans and restrictive side conditions attached to the supply agreements. Both the intent and the actions of the majors show that refinery agreements served to establish monopolistic conditions in the refining sector and to entrench these conditions by restricting competition from outsiders in the marketing sector.

In order to understand the manner in which this was accomplished, the majors' actions must be considered separately in each of three cases. In the first section, the arrangements among existing refiners are examined. It was in this area that the majors chose to coordinate their actions so as to maintain discipline among themselves. The second section concentrates on the manner in which new or potential entrants to refining were treated. The actions of the existing refiners were intended to reduce new entry and to counter the competitive impact of entry when it occurred. The third section deals with the policies that were adopted by refiners with regard to supplying marketers who offered little short run threat of entry to the refining sector. The policies that were implemented here were directed at restricting supply to those firms which engaged in price competition. These policies demonstrate the manner in which successful control at the refining level was employed so as to restrict competition in the marketing sector. They illustrate how the effects of the monopolistic conditions existing at the refining level were exploited downstream to affect the marketing sector.

2. *The Industry Model*

The Canadian subsidiaries of the multinational petroleum industry cannot be regarded as functioning independently of their parent organizations. In the two volumes devoted to the production and the international sectors of the industry, the role that the parent corporations played in coordinating the activity of their Canadian subsidiaries has already been described. Documentation on the refining sector provides additional information on the type and the degree of control that was exercised by the parents. It adds weight to the contention that one of the reasons that the Canadian subsidiaries of the majors were successful in coordinating their actions was the nature of the directives issued by their parent firms.

It was reported in the volume on the international sector that certain refining agreements served to coordinate behaviour. For instance, because Texaco processed Sun Oil's crude in Montreal, Sun Oil's parent ascertained

what transfer price between itself and its Canadian subsidiary would meet with Texaco's approval. Parental coordination also extended to a dictation of refinery exchanges. For instance, it was reported that Texaco's Canadian subsidiary was forced to exchange product with the Golden Eagle refinery in Quebec City even though the arrangement was neither sought nor particularly desired by the Canadian subsidiary. The exchange effected in Canada arose as a result of an arrangement made between parent companies elsewhere in the world.

Another example of parental directive is provided by a second episode that took place in the early nineteen seventies. In April of 1972, Imperial Oil was informed that its parent company and the Texaco parent had held discussions to arrange a processing agreement between Imperial and Texaco Canada Ltd. Imperial reported:

> "In a telephone conversation on April 3, *Mr. Doores advised the writer* that, further to previous discussions between Jersey and Texaco International *Texaco have confirmed their interest in processing by Imperial for Texaco Canada* of 20 MB/D in 1974, growing to 47.5 MB/D in 1978."
>
> (Document #112501, April 4, 1972, Imperial)[31]

Of even greater interest is the fact that the Texaco subsidiary in Canada was not initially informed of this parental agreement. Eight months later in December, an Imperial official reported:

> "I had a long discussion with Mr. John Murray of Texaco Canada on December 8th re. their future requirements of product and how Imperial might fit into their supply thinking. I might add of interest Mr. Murray started his conversation by advising me that he was aware that New York people of both our companies had been talking together and he was not totally happy having found out this particular arrangement. I played that I was totally unaware of any communications along these lines."
>
> (Document #112492, December 11, 1972, Imperial)[32]

That a refining agreement should have been reached at the international level and that responsibility for implementing it in Canada fell to Imperial is not surprising. Leadership had been conferred by the industry upon Imperial at the production level as well. Because of this, it is important to outline Imperial's objectives in the refining sector. For even if the evidence quoted above was not available, Imperial had a special status since it was the largest refiner, with long standing representation in each of the Canadian marketing regions. By dint of its position at the head of the industry, Imperial was in a position to influence the objectives that were adopted by the other majors. For the same reason, the objectives of the second largest firm in the refining sector — Gulf — are equally important.

Documentation indicates that both Imperial and Gulf sought to become self-sufficient in product supply. Self-sufficiency was intended to be used to develop 'control' of the refining sector. Several statements from both

Gulf and Imperial emphasize the importance of self-sufficiency to each of these companies. For instance, Shell reported on the following conversation with Gulf:

> "Gulf said their immediate plans call for a sizeable expansion at Edmonton which they say they can accomplish at relatively low cost. They are not interested in a situation where they 'have to rely on others' and 'are not prepared to lose their imminent self-sufficiency for small savings'."
>
> (Document #24123, August 17, 1973, Shell)[33]

Gulf noted that it would be to its advantage to have refineries located in each of the "prime Canadian refining areas..." (Document # 78064).[34] For the success of Gulf's stated objective of self-sufficiency depended upon its being able to locate refineries across Canada. Shell reported that Gulf saw itself able to achieve this pattern of representation:

> "Gulf stated 'we can supply ourselves across the country with a small push and this has been our plan for years.'"
>
> (Document #24124, August 17, 1973, Shell)[35]

While Gulf was establishing nation-wide representation by the early nineteen seventies, Imperial had long been in this position. This meant Imperial was less reliant than others on exchanges for supply of product. In Gulf's words, "Imperial's general posture has been to supply their own needs..." (Document #73333).[36] Imperial's objectives are outlined in the following excerpt from Imperial's Logistics Department's "Long Range Outlook and 1974 Capital Budget". Imperial's strategy for obtaining product supply was described as:

"1. *Continue to rely on our own production for product supply.*

2. Import of overhead products as required to balance production.

3. Maximum use will be made of economic inter-regional support of volume to defer capital expenditure either directly or via exchanges.

3. [sic] *Exchanges and processing agreements will continue similar to todays pattern.* The major exception is the termination of product from Ultramar which is assumed to have ceased by 1975. Others are under development."

(Document #98679, July 1973, Imperial, emphasis added)[37]

It is evident that Imperial's "general posture . . .to supply their own needs" did not preclude it from engaging in exchanges or processing agreements. But, in general, Imperial was not dependent upon other refiners for long-term supply on a large scale. Imperial gives two reasons for its position. The first was that by always keeping ahead of its own demand, but by agreeing to process for others, it could obtain a cost advantage. The second was that this would give Imperial the ability to 'control' industry processing arrangements. The importance of both objectives is illustrated in the following excerpt from an Imperial document. A proposal for the processing of crude oil by Gulf for

Imperial was rejected by an Imperial official because it would not accord with Imperial's desire to maintain a cost advantage for itself:

> "Such a proposal places firmly in B.A.'s [Gulf's] hands advantages of cheap expansion and considerable operating flexibility, with a substantial control of industry spare capacity. These advantages would be used to provide a lower cost operation for them and encourage them to become involved in industry reciprocal processing deals, all of which advantages we feel we should attempt to keep in Imperial's hands. It is possible that Imperial's program, as presently planned, might be utilized, in fact, to delay B.A.'s second stage."
>
> (Document #88735, November 7, 1968, Imperial)[38]

Implicit in this statement is that Imperial did not want Gulf to have "control of industry spare capacity" because this was its own goal. Indeed this was explicitly stated in the recommendation that was made to reject the processing arrangement with Gulf:

> "Recommendation:
>
> That Imperial not commit to B.A. for firm processing capacity from their expanded Edmonton refinery, but that we enter into discussions immediately with B.A. and Interprovincial concerning our interests in the distribution system to be utilized in moving products from Edmonton south and east.
>
> . . .
>
> "Reasons for Recommendation:
>
> A commitment to B.A. for firm processing capacity for a 3-5 year period provides them with a significant competitive advantage in terms of market/supply capability and distribution facilities. *These advantages to B.A. are not consistent with Imperial's objective of being the lowest-cost operator and maintaining reasonable control of spare industry capacity.*"
>
> (Document #97859, November 5, 1968, Imperial, emphasis added)[39]

The objective of controlling spare capacity can be found in other Imperial documents. For instance, the following excerpt from an Imperial review of a long-term supply agreement with Pacific Petroleums emphasizes the "control" objective. One factor, Imperial noted, that would suggest the desirability of an arrangement with Pacific Petroleums was the "control of spare capacity" this would confer upon Imperial:

> "We would defer construction of additional competitive refiner capcity [sic] in the Prairies. This would increase our degree of control of spare capacity."
>
> (Document #91876, October 8, 1968, Imperial)[40]

Control of surplus or spare capacity obviously promised certain cost advantages. Imperial's comments in the following excerpt substantiate this point:

> "The provision of substantial spare capacity in B.A.'s expanded Edmonton refinery (which would result from an Imperial commitment to buy capacity for a 3-5 year period) presents them with opportunities for lower costs operation, market and supply flexibility, and distribution advantages which are not in Imperial's long-term interest."
>
> (Document #97860, November 5, 1968, Imperial)[41]

Gulf, implicitly, made the same point in discussing its plans for consolidation of its Prairie operations in Edmonton:

> "British American [Gulf], by the construction of new facilities in Edmonton, will be in an excellent position to not only meet its own future demand but also benefit from processing crude oil for our competitors."
>
> (Document #59212, December 18, 1967, Gulf)[42]

Thus self-sufficiency and 'control of spare capacity' in the refining sector was perceived to promise real pecuniary benefits related to cost reductions. It also conferred other advantages upon the firms which developed 'control'. These advantages arose from the way 'control' could be used to weld the refiners together into a unit and to entrench their position in the marketing sector at the expense of independent non-integrated retailers.

The study of the production sector showed the intention and the actions of the same two firms when placed in the same situation in the production sector. There, 'control' was also sought. Once 'control' over crude purchasing had been established, these same two firms — Gulf and Imperial — used the concomitant market power that this conferred to lead the price setting process and to discriminate against some of the small refiners. As in the production sector, the same intent to 'control' can be found in the refining sector. One indication of the similarity of intent can be found in the proximity with which the two sectors were related in policy discussions. For instance, when Imperial decided not to use Gulf facilities in Edmonton, the recommendations contained the following:

> "(1) not commit to B.A. for firm processing capacity;
>
> . . .
>
> "(5) persuade B.A. to use I.P.L. for product distribution east from Edmonton; . . ."
>
> (Document #97860-1, November 5, 1968, Imperial)[43]

The reason Imperial chose to persuade Gulf to adopt Interprovincial Pipe Line for distribution of product for the new refinery was:

> "Imperial's pipeline distribution interests suggest the use of modified Interprovincial facilities rather than the installation of an industry pipeline, as currently planned by B.A."
>
> (Document #97859, November 5, 1968, Imperial)[44]

The way in which Imperial used Interprovincial to facilitate its 'control' over the crude purchasing sector has already been described in the production volume.

The meaning of the advantages of the 'control of spare capacity' that was specified in the same set of recommendations listed above must be interpreted in this context.

The way in which this advantage was used will be described in succeeding sections. Self-sufficiency and size conferred a cost advantage upon Imperial and Gulf. In turn, this provided a disciplinary tool similar to that which existed in the production sector. In the latter sector, crude streams whose value was greater than their cost could be withdrawn from a refiner if the refiner did not contribute to the maintenance of oligopoly discipline. Analogous power existed at the refinery level since refinery exchanges were essential to those national majors such as Shell and Texaco which did not have country-wide refinery representation. This would also have applied to regional majors and to those firms which were only marketers but which had no other source of supply than domestic refiners. Control over spare tradeable capacity left the leading refiners free to discriminate among customers on the basis of their competitiveness in downstream markets, to control volume growth of the other industry participants so as to reduce competition, and even to refuse to supply those firms which were 'price competitive' in downstream markets.

It should be emphasized that the system being described did not rely only upon the actions of Imperial and Gulf. Evidence shows the other refiners also exploited the discretionary market power that they possessed — especially against independent marketers. But this was facilitated by the degree of product exchanges that served to link these refiners with the two dominant firms and by the meshing of the interests of all refiners. In this respect, as in others, the refinery model resembled that found in the production sector. There too, there was a hierarchical relationship with Imperial and Gulf at the head; but these two firms were not responsible for making all decisions. The power they could exert from the top was sufficient to ensure a recognition of a mutuality of interest and to ensure the adoption of parallel actions to support the common objective that was adopted by the majors.

The remaining sections demonstrate how the discretionary market power arising from refinery ownership was exploited at all three levels — among existing refiners, over potential refiners, and over independent marketers.

3. *Relations Among Existing Refiners*

(a) *Interdependence and the Industry-Refinery Approach*

The degree of industry concentration and the extent of refinery linkages together helped to create a strong feeling of interdependence among the four national majors — Shell, Gulf, Imperial, and Texaco. Interdependence resulted in the recognition that competition among this group was limited

because of the reaction that could be expected to agressive behaviour. Shell, for example, stated that substantial growth was not attainable via internal expansion, but only by merger:

> "Measurable growth in excess of industry growth, historically, has been practicable only through acquisition."
>
> (Document #27882, May 3, 1973, Shell)[45]

Ten years later, Shell made a statement that since its market share in the Maritimes had reached the level enjoyed elsewhere, it felt it had exhausted the tolerance of the other majors:

> "In the Maritimes, we have in recent years gained several percentage penetration points and reached the level of participation approximately that in B.C., Quebec and Alberta. *It is unlikely that we will be able to continue to penetrate much further without inviting competitive retaliation.*"
>
> (Document #27926, May 3, 1973, Shell, emphasis added)[46]

In the same year, Shell commented that its strategy should essentially embrace the status quo:

> "The overall light oil objective is neither a 'defeatist' one nor an unduly optimistic one. It *results* from the two basic alternatives of either planning long-term penetration or consciously ceding market position. The former inevitably invites competitive reaction in one form or another, resulting in depressed net income growth, overall profitability or both."
>
> (Document #27882, May 3, 1973, Shell)[47]

Other majors also consciously strove not to take business away from their major competitors. Gulf, for instance, was well aware of the competitive retaliation that could be expected if it acted agressively — as the following quotation indicates:

> "In response to your letter of March 9, 1972, it was encouraging to see that we were close in the four districts bid. As we discussed on the phone, we are in agreement with your proposal subject to your judgement of how you are progressing toward your 1972 Plan objectives.
>
> "I will be sending out a general note soon in this regard but will summarize as follows. Of the two objectives; volume or *netback* realization, the latter is over-riding. As far as I am concerned performance to sales volume plan will be completely satisfactory. *Overshooting sales volume in total is not satisfactory as it contributes too much of a grasp into existing business of competitors and will quickly catch up with us by retaliation.*"
>
> (Document #71748, March 16, 1972, Gulf, emphasis added in last sentence)[48]

It must not, however, be inferred from these statements that competition was not possible in this industry. The marketing sector has shown that, in contrast to the majors, the independent marketers, who were more efficient, were not adverse to price competition. Significantly, the difference between the

two groups received recognition at the refining level. The following excerpt from a Gulf document shows that this company recognized that refinery sales to the major refiners would not have much effect on the price, but that sales to the independents could disrupt the market:

> "Mr. Clendining indicated that Special Sales to major refiner-marketers have little effect, while sales to certain resellers have the result of setting the market price."
>
> (Document #66143, October 3, 1968, Gulf)[49]

Together, the information presented here and in the marketing volume shows that the majors tended not to be aggressive one with another. Moreover they did so all the while understanding that this was the general policy that could be expected of others. As such it demonstrates that the majors functioned as a distinct unit in this industry — with common goals and similar attitudes. One of the reasons for the development of this mutuality of interest was the extent of inter-refinery agreements. The earlier section described the inter-firm linkages that were created, but it did not reveal the degree of complexity that had developed in these arrangements. One facet of this complexity was the development of two and three way exchanges — both by company and by region.

An example of the extensive inter-regional ties that were developed can be found in the Gulf-Shell exchange involving supply points in Quebec, Ontario, the Prairies, and British Columbia. The following excerpt summarizes preliminary discussions between these two companies in 1967 and shows how many regions would have been linked together:

> "It has become increasingly evident that Shell is willing to co-operate with B.A. to prevent duplication of capital expenditures for processing capacity in Canada. Indications are that Shell are willing to commit capital at St. Boniface [Manitoba], Sarnia [Ontario] and Montreal [Quebec] and to consider long term mutual processing at these points with return possibly at Port Moody [British Columbia], Edmonton, Calgary [Alberta] and Moose Jaw [Saskatchewan]. Shell's Montreal expansion could result in an exchange of products with Point Tupper making available capacity at Montreal for this [sic] additional sales or processing for others by B.A."
>
> (Document #78056, July 12, 1967, Gulf)[50]

Another example of the complexity of the majors' product-supply arrangements is provided by refiner rationalization that extended across national boundaries. The following excerpts from Gulf documents illustrate the extent of inter-company planning in this area:

> "The industry needs to build lube facilities and the question really becomes who is going to do it.
>
> "Some time ago there were indications from Pittsburgh that Texas Corp. were interested in a possible joint deal in the U.S. and we have also had some discussions with Texaco Canada in this regard for a facility in Canada. At the present time all of Texaco Canada's supply is imported from the U.S.

"We were wondering whether you have considered Texaco's offer any further or whether that possibility has now disappeared. It seems to us that perhaps between the four companies two facilities could be built: one in the U.S. and one in Canada (Gulf to build one and Texas the other). Mutual processing or exchange arrangements could be worked out between the four companies."

(Document #79249-50, May 28, 1973, Gulf)[51]

In addition to simultaneous exchanges such as those outlined above, the industry engaged in delayed exchanges or what was often referred to as 'leap-frogging'. For instance, in a 1966 discussion between Gulf and Shell over a Prairies exchange, Shell noted:

"They [Gulf] were very keen to avoid the experience of recent years in Ontario, where surplus industry capacity had affected prices adversely. 'Leap-frogging' seemed the best answer, and Shell agreed in principle with this philosophy."

(Document #25201, September 27, 1966, Shell)[52]

'Leap-frogging' involved the provision of product by one company, in the present, in exchange for a return of product in the future. The interests of the two companies were, as a result, bound together for several years. One example of discussions of this nature is provided by the following summary of understandings reached at the uppermost executive level between Shell and Gulf:

"In response to Shell's question on Gulf's outlook, Mr. DeGrandis said that while Gulf were not actually engaged in a thorough look beyond 1980, we were thinking in terms of the conceptual understanding discussed by Messrs. McAfee and Bridges[1] that both Shell and Gulf should work toward maximum use of their respective refining facilities to achieve the best economic benefit for both companies. Shell acknowledged this concept and mentioned this also was their basic aim and commented that in view of this principle since Gulf took the first step to build Edmonton Refinery, it was probably Shell's turn to initiate a major refinery construction program."

(Document #63645, August 21, 1972, Gulf)[53]

While this excerpt illustrates the nature of understandings reached by these two companies about their relative responsibilities under the agreement, the following quotation shows the length of time envisaged for the arrangement. Shell, in discussing the length of time over which the 'leap-frogging' arrangement would extend, noted:

"We advised Gulf that our suggested basis for discussion would provide for Gulf to supply us in the West until 1978/9 in return for our supplying them (i) in Ontario after the expiry of the present deal (assuming Gulf will stretch their entitlement to end 1977) and (ii) the West from 1978/9 onwards until their own next refinery

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1. Mr. McAfee was Chief Executive Officer for Gulf Canada; Mr. Bridges held a similar position at Shell.

expansion came about. We said that it seemed to us that scope existed for 'leap frogging' capacity increments in this way to the mutual benefit of both companies, as we had done in the past."

(Document #24123, August 17, 1973, Shell)[54]

Gulf and Shell were not the only firms which adopted this strategy of 'leap-frogging' capacity. The following excerpt indicates that British Petroleum possessed a similar philosophy:

"In principle, I believe it is always better to build in a leapfrog manner (i.e., one processing for another, than vice-versa) thereby leaving minimum surplus capacity to put stress upon the market."

(Document #10913, January 6, 1972, B.P.)[55]

Imperial, too, considered time exchanges with other companies. The following excerpt demonstrates that Imperial intended to supply Texaco in the early nineteen seventies in order to arrange for a reciprocal arrangement in later years:

"On the Prairies however Imperial's capacity after Wescan exceeds our demand by 30MB/D in '75.

"It was therefore recommended that I.O.L.'s excess capacity on the Prairies after Wescan be traded for some Texaco product in Ontario after '74. This would preclude Texaco investing in more refinery capacity on the Prairies and help round out Wescan's capacity. *This recommendation includes supplying Texaco in '72, '73 and early '74 in Ontario so that a good reciprocal arrangement could be made for the later years.*"

(Document #122676, July, 1971, Imperial, emphasis added)[56]

Finally, arrangements were so complex that sometimes they not only involved more than one region but also more than two companies. One example of this type of linkage is provided by plans made by Imperial in 1973 to exchange with both Texaco and Petrofina simultaneously. The result would have been to link Alberta, Ontario, and Quebec. In the following excerpt Imperial discusses two simultaneous supply arrangements that would effectively have utilized its anticipated excess capacity at Edmonton and cover its supply shortage at Montreal — but not by directly trading one for the other:

"Fina will complete an expansion in 1975 at Montreal and will require product in Ontario. It may be possible to arrange a trade with Fina in Ontario which could spring capacity at Montreal. Assuming this is back-to-back with Texaco, this indirectly moves Strathcona [Edmonton] capacity to Montreal."

(Document #126452-3, July 10, 1973, Imperial)[57]

Imperial recognized that Texaco would need refining capacity in Edmonton but would have excess capacity in Ontario once its new refinery came on stream at Nanticoke. Imperial, on the other hand, would have a surplus in Edmonton and a shortage in Montreal. Fina, would have surplus in Montreal but needed

product in Ontario. Imperial saw that it could supply Texaco in Edmonton in return for product in Ontario which it would then trade with Fina for product in Montreal. Thus, Fina, Texaco, and Imperial interests would have been linked by this arrangement.

A similar three-company interchange was arranged by Imperial in eastern Canada in the early nineteen seventies. Irving had excess capacity in New Brunswick and required product in Montreal. Shell had excess capacity in Montreal but no refinery in the Maritimes. Irving approached Shell in 1972 "soliciting our [Shell] interest in an exchange arrangement ex St. John for product from our Montreal refinery" (Document #27324).[58] Even though Shell expressed interest in the proposed arrangement, the exchange did not materialize. Shell's Vice-President of Transportation and Supplies informed the President:

> "The possibility of a deal with Irving never materialized in that, despite all efforts, we were unable to get Irving to come to the discussion table. We learned later that Irving had made contractual arrangements with Imperial Oil which precluded Irving's being able to offer us product at St. John before 1975."
>
> (Document #27325, May 24, 1973, Shell)[59]

Instead, Imperial took Shell's volume in Montreal and provided Shell with product in the Maritimes. It returned product to Irving in Quebec in return for supply in the Maritimes.

By themselves, none of these agreements should necessarily be construed as having been entered in order just to reduce competition. In the record of discussion surrounding the exchanges the need to avoid duplication of refinery facilities and over-capacity is stressed. The refining sector was such that the scale of plant that best took advantage of economies of scale was large. Therefore, timing problems could well develop in planning the sequencing of refinery expansion and exchanges could facilitate optimal investment programmes. What these examples do show is the extent of interdependence that necessarily developed as a result of these agreements.

Contributing to the development of mutual interdependence was the extent of information exchanges that took place among the leading refiners. Throughout the process of negotiations, it was recognized that substantial information was required by each firm on the activities of others. Shell emphasized in the following quotation that it would carefully analyse its competitors' actions when planning refinery investments:

> "*Competitive Strategies.* It is well recognized that the viability of a strategy [of capital investment in refining] depends to a large degree on the strategies of one's major competitors. History attests to the folly of over coincident aggressiveness on the part of two or more majors with attendant overbuilding in any area of limited marketability. *Shell Canada's strategy must include an analysis of the major competitors [sic] action.*"
>
> (Document #43577, August 29, 1973, Shell, emphasis added in last sentence)[60]

Such analyses did not rely upon an arm's-length gathering of information. Majors met with one another and reviewed in detail their long-term plans. For instance, in 1968, Imperial and Gulf met to:

> "... review the opportunities, of mutual interest to both companies, in the area of processing agreements in all areas of Canada. The intent to avoid duplicate capital investments in any given year and unusable surplus capacity with its adverse impact on markets."
>
> (Document #78554, June 18, 1968, Gulf)[61]

Discussions as to how refining investment could be scheduled to minimize disruptions involved the exchange of a substantial amount of information. Product demands by type, projections of demand, supply capabilities, and distribution systems were discussed. For instance, during discussions held between Gulf and Husky in the late nineteen sixties, Gulf reported:

> "... it was decided to investigate jointly certain areas of mutual interest, particularly the refining and marketing of asphalt and related activities. The objective of this approach is to maximize the profits of these activities through mutual co-operation and utilization of facilities."
>
> (Document #137435, April 23, 1968, Gulf)[62]

The nature of the detail inherent in the joint study was then described at length:

> "The first requirement is to determine the joint demands by area and the plants that can most economically supply these demands. Market data is available by province and by supplying refinery. It will be necessary to develop the data by economic supply areas for use in supply and distribution studies."
>
> (Document #137440, April 23, 1968, Gulf)[63]

While the degree of interdependence and the amount of information that was exchanged might be sufficient to infer a coordination of actions and a mutuality of interest that militated against competition, it is not necessary to have to rely on inference alone. The industry leader admitted that because of its leadership, the majors had developed a set of product-supply agreements which considerably reduced the leeway for independent action and which belied the argument that the industry was "truly competitive". A Vice-President of Imperial, in 1971, wrote:

> "During the past few years, with Imperial taking a number of the initiatives, we have moved a considerable way towards what might be called the *'industry refinery' approach*. At this moment, partly as a result of our Strathcona thinking, and partly as a result of our Sarnia and Montreal positions, we are considering some major additional steps, even to the extent of three and four-way exchange transactions.
>
> "In an area of this kind, no one can say just how much is too much, or what the precise penalties will be if too much does happen. I would suggest, however, that we should ask ourselves some very serious questions about future consequences. *With the degree of industry supply interchange now in existence and contemplated, it will be very difficult for us to argue convincingly that ours is a truly competitive industry.*"
>
> (Document #111864, September 3, 1971, Imperial, emphasis added)[64]

Thus far, only the pattern of exchanges, their complexity, their comprehensiveness, and the extent to which the industry's participants exchanged information on strategies have been adduced to describe what Imperial accurately describes as "the 'industry refinery' approach". But there is substantially more information that reveals aspects of the evolution of "the 'industry refinery' approach" and that serves to explain how it was used to entrench monopolistic conditions in the industry. This information makes it clear that the approach adopted was deliberately intended to link the interests of the majors so as to reduce and to limit competition. These aspects will be dealt with in subsequent sections.

(b) *The Exercise of Discretionary Power*

Three issues dominate this study of the refining sector: the extent to which discretionary power existed within this sector; the extent to which it was magnified by certain arrangements; and the extent to which its use was inimical to competition. Subsequent sections concentrate on the latter two issues. The extent to which relations among the majors themselves provided evidence of the existence and the use of discretionary power is examined here.

Discretionary market power in the refining sector as well as the production sector developed not just from the size of the leading firms but from a myriad of arrangements that firms in the industry adopted. In neither sector did these arrangements develop by chance. They were the result of the initial presence of a degree of monopoly power that facilitated the reaching of agreements. In turn, these agreements enhanced and extended market control.

In the production sector, the leading firms — Imperial and Gulf — were able to bring the industry together to reach an agreement on prices and on production restrictions because they possessed discretionary power. Being able to deny a company crude or to impose a cost penalty by denying it access to the most 'desirable' crudes served to guarantee agreement with and adherance to industry arrangements. The same situation developed in the refining sector. As has been demonstrated, Imperial and Gulf possessed an advantage the other refiners did not have. They were represented in each regional market and were virtually self-sufficient. Their objective was to 'control' capacity. With the most extensive representation in the refining sector, Imperial and Gulf were in the position to provide themselves with a cost advantage and to offer benefits to other refiners as long as the latter followed a non-aggressive policy in marketing.

The relationship of both Gulf and Imperial to Shell illustrates the dominant position and the degree of 'control' possessed by the two leading firms. Each had a major supply agreement with Shell in the late nineteen sixties and early nineteen seventies. Gulf had a product-supply arrangement with Shell in the Prairies, Ontario, and British Columbia. Imperial exchanged product with

Shell between Montreal and the Maritimes. Even though Shell was a large integrated refiner, it found itself dependent upon Imperial and Gulf.

In the late nineteen sixties and early nineteen seventies Gulf and Shell renegotiated their Prairie exchange whereby Gulf supplied Shell in Alberta and Saskatchewan in return for product at Winnipeg. Gulf, with its rationalization of the Prairie refining network, was in a stronger position than previously. It now had a low-cost supply at Winnipeg even though it would have to ship the product by pipeline all the way from Edmonton. Gulf described its position as follows:

> "Gulf Canada is in the drivers seat it being in a position to more economically achieve alternative product supply in the areas proposed covered by Shell and to dispose of surplus product availability in British Columbia."
>
> (Document #81130, January 20, 1969, Gulf)[65]

Shell was cognizant that the outcome of its negotiations with potential trading partners depended on relative bargaining strengths. This is emphasized by the following excerpt:

> "Supplies is not in a position to provide a definitive answer as to what level of St. Boniface [Shell's Manitoba refinery] Trading penalty the Task Force should assign to Cases A, B, & G. *The level of penalty can only be determined following negotiations with prospective trading partners, and is dependent not so much on the actual light oil transportation differential between Edmonton and St. Boniface but rather the relative bargaining strengths of both Shell and potential partners* and also what Shell may be prepared to yield in other areas. In summary, negotiations with competitors will result in a 'package deal' of which a St. Boniface trading penalty is only one portion."
>
> (Document #29603, September 7, 1972, Shell, emphasis added)[66]

Under the existing agreement, Gulf had paid a crude oil differential of 46.7 cents per barrel at Winnipeg to Shell. This was the light oil equivalent cost of moving crude oil from Edmonton to Winnipeg. However, in the renegotiations, Gulf, recognizing that it was in the "drivers seat", attempted to eliminate the differential. This is evident from the following excerpt from Shell documents:

> "In negotiations with Gulf, Shell's proposal has recognized the need to update costs as required by the situation that will prevail at that time. Thus, the transportation differentials (Edmonton taken as base point) would be as follows:
>
> . . .
>
> "(3) Shell would charge Gulf 41¢/bbl. differential at Winnipeg, reflecting the anticipated theoretical tariff if the products pipeline were extended into Winnipeg. Gulf is presently charged 46.7¢/bbl., which is the light oil equivalent of the cost of moving crude oil from Edmonton to Winnipeg.
>
> "*Gulf's counter proposal initially asked for product at Winnipeg with zero differential.* This has subsequently been revised by them to 14¢/bbl. At this level the

> resulting additional cost to Shell over our proposal would be $900M/yr. *An analysis of their offer to establish its rationale appears to indicate that Gulf is endeavouring to have Shell subsidize them to the level of their best case, namely, having a product pipeline available from Edmonton to Winnipeg, with terminals at Whitewood, Saskatchewan and Brandon, Manitoba, and line tariffs based on volumes equivalent to supplying all majors in Saskatchewan/Manitoba except Shell (e.g., 19¢/bbl at Regina, 41¢/bbl. at Winnipeg).* On the basis of its current agreement with Shell, following the proposed closure of its Brandon refinery, Gulf will be incurring a back-hauling cost on product moved from St. Boniface into Western Manitoba. This is thought to represent a major portion of the $900M/yr. that Gulf is endeavouring to recover."
>
> (Document #26423-4, April 22, 1969, Shell, emphasis added)[67]

The end result was that Gulf was able to reduce the transportation cost penalty at St. Boniface to only 28.3 cents per barrel in consideration of other transportation economies that might have been available to Gulf. Gulf, by virtue of its potential self-sufficiency, was able to realize a saving of some 18.4 cents per barrel in its exchange arrangement.

The Gulf-Shell negotiations, therefore, show the cost advantages a self-sufficient refiner could enjoy. The Imperial-Shell discussions show a similar phenomenon. But what is more important, they demonstrate that Imperial was willing to discipline its partner, Shell, at the refining level for being too aggressive in the marketing sector.

Shell, in the Maritimes, was supplied by Imperial in exchange for product returned in Montreal. Technically, the contract was a purchase/sale agreement but the intent of the agreement was to keep the quantities bought and sold by each company in balance, product by product (Document #25360).[69] Shell did not have a refinery in the Maritimes and would, without the agreement, have had to supply its network therein from its Montreal East Refinery at an increase in transportation and plant costs of 75 cents per barrel[1] (Document #27169).[71]

The agreement between Imperial and Shell, originally signed in 1963, was renegotiated in 1967. In July, 1972, Imperial gave notice for termination. Shell recognized that Imperial did this because Shell had been growing too rapidly in the Maritimes. In 1971/72, Imperial had expressed its dissatisfaction with the agreement because of Shell's marketing policies. Shell noted:

> "There [sic] [Imperial's] present attitude is that we have built a market with their facilities, we are aggressive and threatening them all the time, and they are not going to help and in fact get as tough as possible with us."
>
> (Document #23633, undated, Shell)[72]

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1. Shell could not obtain supply from foreign sources as it did not have an ocean terminal for large scale import in the Maritimes (Document #23966).[70]

While Imperial felt a need to restrict Shell further, Shell's own marketing department already felt restricted by the "current Imperial Agreement" (Document #23842).[73] Nevertheless, in the negotiations that followed, the terms of the agreement that Imperial offered placed much greater restrictions on Shell's ability to compete in the marketing sector.

By virtue of its position, Imperial under the original contract had extracted from Shell a premium of about 20 cents per barrel (Document #27168-9).[74] In renegotiations, Imperial demanded "30¢/bbl. extra" (Document #27312).[75] However, the major change that was imposed upon Shell was the imposition of a penalty for liftings above a base volume. Under the previous contract, Shell had been granted flexibility and had not been penalized for lifting more than the contract volume (Document #25359).[76] This situation had permitted Shell to expand in the marketing sector. The new arrangement promised to make any expansion above 'normal growth' rates much more costly to Shell. In the event Shell's estimated requirements exceeded the base volume, Imperial was to advise Shell of its ability to supply all or part of the excess requirement and the estimated additional cost to Shell of supplying all or part of the excess volume (*Duces Tecum* agreement #3082-3).[77] The net effect of the higher charges was in Shell's words, "a significant increase" (Document #23640)[78] in its product costs.

Not only did Imperial impose a cost escalation clause on Shell's liftings above a certain base volume, but it also restricted Shell's access to other sources of product. Imperial's position was that Shell would not generally be allowed to obtain product from third party sources.[1] Shell explained:

> "Shell renewed the agreement [Maritimes/MER] because Imperial were not prepared to let Shell deal with another company for part of the volume under current contract terms."
>
> (Document #25358, October 15, 1971, Shell)[80]

Shell documents indicate that Imperial's restrictions on this matter were designed to reduce Shell's flexibility:

> "Our main problem is that we do not have flexibility to deal with other supply sources, therefore we cannot force any competition to IO [Imperial Oil] to control our costs. Also IOL undoubtedly realize we are in this position and will not readily release us from dependence on distribution system as it is included in the contract ie contract names places & prices."
>
> (Document #23632, undated, Shell)[81]

As part of this strategy, Imperial negotiated a three way deal between itself, Irving, and Shell. This arrangement left Imperial supplying Irving in Quebec

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1. Shell noted that its agreement with Imperial on this matter was "tacit" (Document #23842).[79]

with product received from Shell and Shell in the Maritimes with product received from Irving. The net result was that both companies were kept within Imperial's sphere of influence.

In summary, Imperial still continued to supply Shell at a penalty less than that which would have caused the latter to ship product to the Maritimes from Quebec. Nevertheless, it was disciplined for failing to abide by a tacit agreement not to act too aggressively.

Both examples in this section illustrate that discretionary power was possessed by the major refiners and could be used to provide themselves with a cost advantage. However, the significant point is not that this was exploited completely; but that it was offered in part to other refiners such as Shell. Moreover, the offer was not unconditional. Imperial's behaviour demonstrated that it was contingent upon an acceptance of non-rivalrous behaviour in marketing. This is similar to the intent underlying other agreements that were arranged by the firms in the refining sector. Agreements were aimed at providing the conditions whereby behaviour could best be coordinated. In some cases, this meant enhancing interdependence; in others, it amounted to the provision of an efficacious mechanism to discipline those who threatened to disregard oligopoly discipline.

(c) *Linkage of Interests and the 'Entry Fee'*

The preceding section has demonstrated that power was not equally distributed among the majors and that the discretion that existed was used to punish aggressive behaviour in marketing. Discretionary power conferred by ownership of refining facilities was used to place restrictions upon the other firms in order to reduce competition in the downstream sector. Competition was also reduced through the use of a second policy — the imposition of what is variously described as an 'entry fee', 'entrance fee' and 'ante' for acceptance into the 'game', namely the industry.

Evidence of an understanding that a fee relating to investment was required for acceptance into the industry can be found in the following quotation from Gulf:

> "We do believe that the oil industry generally, although grudgingly, will allow a participant who has paid his ante, to play the game; the ante in this game being the capital for refining, distributing and selling products."
>
> (Document #71248, undated, Gulf)[82]

The significance of the quotation lies equally in the notion that an 'entry fee' was required and in the notion that the industry set the rules of the 'game'. The meaning of the 'entry fee' as well as the rules of the 'game' as understood by the industry can be found in the actual dealings between companies where the explicit mention of an 'entry fee' arises. These cases demonstrate the rules that

were being applied — the rules to which Gulf was referring. Companies which had not paid an 'entry fee'; that is, companies which had not made a sufficient investment in refining capacity or in marketing distribution facilities would either not be supplied or would be penalized in the terms of the supply agreement.

Imperial's policy in this regard is demonstrated by considerations that were made explicit to Shell during the renegotiation of a reciprocal purchase/sale agreement covering Montreal and the Maritimes. Shell noted that Imperial advised they were not satisfied with the extent of Shell's investment in the Maritimes:

> "IO [Imperial Oil] made the point that we [Shell] do not have any facilities in the Maritimes and they do not wish to help us out any more than they are."
>
> (Document #23946, August 18, 1971, Shell)[83]

Shell was even more explicit as to the need for an "entrance fee" in the following excerpt describing discussions that were held with Imperial in 1972:

> "IO [Imperial Oil] may claim we have no store but in fact we have invested in Montreal & by exchange invested in Maritimes so we have paid an *entrance fee*, although we have not paid for distribution network."
>
> (Document #23633, undated, Shell, emphasis added)[84]

This point was again stressed in the following excerpt from a Shell document:

> "Imperial refused to consider our suggestions on the grounds that we had nothing to offer them and furthermore they were unwilling to help us in the Maritimes more than currently. *This latter comment was a reference to the fact that we have no significant facilities of our own in that region.*"
>
> (Document #27323, May 24, 1973, Shell, emphasis added)[85]

Although Shell was treated in this fashion by Imperial, Shell was not averse to imposing the same standards on other companies when it was approached for product. In the following excerpt from an evaluation of a possible supply agreement with Murphy, Shell indicated the same desire to obtain an investment commitment from this company:

> ". . . from a *concern* [Shell] point of view, Murphy is a Texaco-like organization:
>
> 'They refine not, neither do they terminal'. "Instead they pick up their processed material at another's refinery rack; throughput on others' storage; pick up at marketers' plants — e.g. Shell at Sept Isles. In Ottawa they have purchased land adjacent to Sun, have developed *one* tank, and are in joint-use of total Murphy/Sun storage with Sun.
>
> "It's time that Murphy committed *their* capital to a refinery, marine terminals, plants, etc."
>
> (Document #42719, February 21, 1973, Shell)[86]

It is important to identify the reason behind this demand for an 'entry fee'. At first glance, the explanation might lie in profitability considerations. For instance, Shell in its evaluation of a processing arrangement with Texaco felt it should be trying to reduce Texaco's profitability by forcing it to commit capital to refining:

> "We should be trying to eliminate the profitability leverage Texaco have realized in the past through limiting their manufacturing investment."
>
> (Document #31039, February 16, 1972, Shell)[87]

However, the explanation of profitability is, by itself, insufficient to account for the demand for an 'entry fee'. For it does not explain why investment in capital at the refining level was not recovered in processing charges or in the price of product sold. If anything, Shell's desire to reduce Texaco's profitability leverage suggests a distortion of the pricing mechanism at the wholesale level that, because it implies a general unwillingness to sell product, would have interfered with the development of a competitive independent marketing sector.

However, another interpretation of this policy can be found in the behaviour described in the study of the marketing sector. There, it is shown that the majors — led by Imperial — used a predatory pricing policy to discipline those firms which engaged in price competition. Predation, it should be pointed out, is not effective against a firm whose costs are almost entirely variable. Such a firm can simply withdraw from the market at little cost to itself during the period when predation is being practised. On the other hand, this is not the case for a firm with a high percentage of fixed costs in plant and equipment that cannot be quickly liquidated without a loss. For then, the opportunity cost of the capital invested continues during the period of temporary withdrawal. Therefore the latter type of firm is more susceptible to the disciplinary pricing policy that was followed by the majors. The 'entry fee' requirement at the refining level would have served to reinforce the predatory strategy used by the majors in the marketing sector.

(d) *The Acquisition of Information*

The previous section suggests that the product supply arrangements were accompanied by provisions that would have served to weld the refining sector together and to enhance the discretionary power that individual refiners already had. Moreover, the way in which the use of an 'entry fee' would have reinforced the predatory behaviour that existed in the marketing sector suggests these encumbrances were intentionally appended to the supply arrangements. That substantial exchanges of information accompanied product-supply arrangements has already been described. This section shows that product-supply arrangements were deliberately entered into in order to obtain this information with the object of exercising a certain degree of 'control' over the other

firm. Together both the evidence on the entry fee and on the process of information acquisition demonstrate that the majors deliberately organized product supply agreements so as to extend or to entrench monopolistic conditions in the refining sector and to restrict competition.

That entry into a supply arrangement could provide valuable information on a competitor's actions is illustrated by the following excerpt taken from a Shell document. Shell noted that discussions with Gulf for a supply agreement might provide it with information on Gulf's plans for refinery expansion:

> "The balance is made up by imports in the L.T.P. The important point is that we may have shortages which we could cover ex Gulf. Moreover, by including this option, we may learn about any future B.C. supply plans Gulf have."
>
> (Document #23676, August 14, 1972, Shell)[88]

Supply arrangements also gave refiners knowledge of a competitor's marketing plans. For instance Imperial, in 1970, received a request for product from Pacific Petroleums and learned of its plans to expand into a new market. An Imperial official reported:

> "Our Transportation Department regional office in Edmonton reports that their Pacific Petroleums' contact in Calgary has stated that Pacific Pete will be building four service stations in the Thunder Bay area during the next 12-18 months.
>
> "*This information was disclosed in the course of Pacific making a request to Imperial to supply product for the proposed outlets.* This development may be of interest to S & ES Department as a potential market for mogas and to Marketing Automotive as notice of the appearance of a new competitor in the Ontario market."
>
> (Document #123621, July 6, 1970, Imperial, emphasis added)[89]

Thus, as a result of a request for gasoline, Imperial was able to acquire advance information on a new entrant to a specific submarket. In light of the extent to which Imperial employed predatory policies to counter new entrants in marketing, such advance information would have aided Imperial's efforts to restrict competition in the marketing sector.

The previous examples illustrate the degree to which refinery exchanges were regarded as providing the type of information that could be used to entrench the monopolistic position of existing refiners. Shell was even more explicit on the advantages to be had from certain product exchanges. The following excerpt indicates that Shell intended to offer a product-supply arrangement to a new refiner, Shaheen, in order to obtain information and to "control" this firm. Shell's analysis was:

> "... we should negotiate with Shaheen on the basis that we will supply him at Montreal with the understanding that he will invest his money in the Maritimes in plant at Halifax/Moncton or wherever, where we could take the product back. *This would reduce his flexibility in the Montreal area and certainly provide us with a knowledge of his intentions and a certain degree of control....*"
>
> (Document #27320, February 9, 1973, Shell, emphasis added)[91]

Thus information that was garnered from product exchanges at the refinery level was regarded as the key to developing a source of control at the refining level.

(e) *Restrictive Clauses in the Agreements*

(i) *General Issues*

Agreements at the refinery level, even though aimed at the exploitation of economies of scale, enhance or entrench existing monopolistic conditions if they needlessly restrict competition. The 'entry fee' requirement provides one example of a condition associated with refinery agreements that made anti-competitive behaviour, albeit at the marketing level, more effective.

In the refining sector, agreements were intended to facilitate 'control'. While the development of control was facilitated by the acquisition and dissemination of information, 'control' was directly effected through the use of explicit conditions that were attached to agreements and that were aimed at reducing downstream competition. Supply agreements were developed that limited the ability of the company receiving product to compete effectively in the marketplace.

One method used for this purpose involved encumbering the arrangement with a form of market-sharing agreement. Such agreements indirectly maintained the relative position of the parties or prevented a substantive change in their relative market shares. One such market sharing arrangement was accomplished by limiting the product liftings of competitors to their existing demands plus "normal growth". Gulf documentation indicates that its strategy was to restrict the amount other companies lifted from it to their "normal growth":

> "Processing agreements (and exchange agreements) should be entered into only after considering the overall economics to the Corporation and should be geared to providing competitors with volumes required for their *normal growth only*."
>
> (Document #73814, January, 1972, Gulf)[92]

By restricting other companies to a supply that kept them within "normal growth" rates, Gulf's policy would have tended to keep market shares equal. Moreover, this behaviour was aimed deliberately at restricting downstream competition. For instance, when Gulf considered supplying Texaco out of its new Edmonton refinery, its marketing department emphasized the importance of supplying Texaco with an amount of product that would restrict Texaco to "normal growth" rates so that Texaco could not compete with Gulf for the Air Canada contract:

> "In a recent discussion between a representative of Texaco and Mr. J.W. Ussher, it was intimated that we could expect very strong competition from Texaco the next time the Air Canada contract comes up for bid. Therefore, if we are to place more product in Texaco's hands than they absolutely require to maintain their normal growth rate, we can expect to have our own business jeopardized, i.e., the Air Canada account which currently amounts to 12,265,000 gallons, or 350,000 barrels, annually.
>
> "*We [the Marketing Department] basically agree with the principle of selling a part of our excess capacity to any of the three major oil companies competing against us, providing it is within normal growth rates.*"
>
> (Document #60312, April 21, 1971, Gulf, emphasis added)[93]

This document also indicates that Gulf had no misgivings about entering into product-supply arrangements with the other national majors. The reason for this lay in the understanding reached by these companies at the marketing level that manifested itself in mutual forbearance and a virtual lack of price competition. The coordination that developed was generally dependent upon the ties that bound the majors together at the refinery level. But it also depended upon explicit assurances. The following excerpt provides evidence that Shell assured Gulf that its behaviour would be non-aggressive. In negotiations with Gulf, Shell assured this company that any product which Shell received would be used only in its own network:

> "Shell referred to and confirmed their earlier request to prelift clean oils at Regina and Calgary in 1973. *Shell confirmed that any prelifting out of Regina and Calgary would be for Shell Marketing only and not for availability to other majors.* Mr. DeGrandis said that with this condition clarified Gulf will shortly be in a position to reply to Shell's request indicating that if Gulf agrees to Shell's prelifting at Regina and Calgary, Gulf will require payback at Sarnia."
>
> (Document #63646, August 21, 1972, Gulf, emphasis added)[94]

Although Shell might have been allowed to give its word that it would behave in this fashion, more explicit restrictions were placed on smaller refiners

to guarantee they did not sell their product to others. For instance, when Gulf and Husky were negotiating a product exchange, Gulf removed the expression:

> "Husky will have title to its products on an entitlement basis at all times in Gulf's tanks with the same rights as if such products were stored in Husky's owned tankage."
>
> (Document #138401, August 21, 1969, Husky)[95]

Husky noted the reason it had initially requested this clause was that it "would give us the right to deliver products to anyone we choose and this was the reason for the entitlement request" (Document #138218).[96] By the same argument, loss of this privilege meant that Gulf gained a certain degree of 'control' over Husky's choice of customers.

'Territorial exclusivity' was another addendum to product-supply arrangements that restricted competition between refiners. To some extent this was just another variant of a market-sharing arrangement. It, in effect, divided the market between the parties to the agreement. Although agreements might not have formally included 'territorial exclusivity' clauses, documentation indicates the matter was raised at negotiations and that informal understandings were reached on this matter. For example, in a memorandum discussing the Maritimes/Montreal exchange with Imperial, Shell's Transportation and Supply Department indicated that one of the points Imperial was likely to raise was "Formal inclusion of territorial exclusivity" (Document #23629).[97]

One variant of a market-sharing arrangement actually implemented can be found in an agreement made between Imperial and Mobil. In eastern Canada, a company was formed — Seaway Bunkers — to act as a delivery agency for the international customers of Socony-Mobil (Document # 122410).[98] Imperial and Mobil reached an agreement that Seaway would not compete for local business. As an Imperial document explained, there was an:

> "Understanding IOL & Socony — no contracts by Socony (Mobil) for exclusively Can. business."
>
> (Document # 122411, undated, Imperial)[99]

The result of this clause was to restrict competition in Canada. As the Imperial study noted:

> ". . . Imperial's Esso affiliations are being protected from Socony Canadian competition..."
>
> (Document # 122410, undated, Imperial)[100]

(ii) *The Gulf-Husky Agreement as an Example*

Examples of both reciprocal conditions and market-sharing arrangements in the form of territorial divisions can be found in a supply agreement made between Husky and Gulf. This agreement provided for a rationalization

and specialization of the refinery facilities of these two companies on the Prairies. Both the terms of the agreement and its operation demonstrated how restrictive clauses that were appended to product exchange agreements could be utilized to restrict competition.

As a result of the arrangement, Gulf supplied Husky with light oil products and Husky shut down the light oil portion of its refinery. In addition, Husky supplied Gulf with asphalt out of Lloydminster, while Gulf did likewise for Husky at Moose Jaw. The terms of the latter agreement were quite explicit when it came to reciprocal conditions. They were:

> "5 (a). . . the volume of asphalt manufactured by Gulf Canada at Moose Jaw for the account of Husky shall be sufficient to meet Husky's entire asphalt requirements, presently estimated at 400,000 barrels per year, in the marketing area traditionally served by Husky from Moose Jaw; similarly, the volume of asphalt manufactured by Husky at Lloydminster for the account of Gulf shall be sufficient to meet Gulf Canada's entire asphalt requirements in the marketing area traditionally served by Gulf from Saskatoon, presently estimated at 400,000 barrels per year."
>
> (Document #138377-8, December 31, 1969, Husky)[101]

It is clear from drafts of the final agreement that the two parties were intent on imposing provisions on one another that would have had a restrictive effect. For instance, Husky noted that at one stage it was agreed not to include mention of specific quantities in the agreement but rather to use the phrase "each company would endeavour to maintain equal quantities" (Document #138292).[102] Similarly, the following draft concentrated on linking the two companies' shares of market:

> ". . . the supply committed to the processee [Husky] at either location will be limited to the prorata share of asphalt available to Gulf at Lloydminster (the smallest of the two plants involved). This level — to be mutually agreed — is estimated to be 'xx' barrels annually. Under the terms of A above Husky's liftings at Moose Jaw will be similarly restricted unless amended by mutual agreement."
>
> (Document #138288, August 21, 1969, Husky)[103]

It is not so much the existence of the agreement but the way in which it operated that is of interest; for, it was used to restrict the freedom of the two companies. It should be pointed out that Husky was the more efficient and aggressive marketer of asphalt. The following excerpt from a Gulf document outlines its marketing department's perception of Husky:

> "There is a reluctance on the part of Gulf's asphalt marketing people to associate in any asphalt venture with Husky. The major reason pertains to Husky's pricing practices and the possibility of being unable to compete in the market on a profitable basis. *Husky have evidenced their willingness to accept lower asphalt prices and net backs over the years than has Gulf Canada.*"
>
> (Document #80483, April 23, 1969, Gulf, emphasis added)[104]

It is, therefore, significant that Gulf — the less aggressive and larger of the two companies — insisted on imposing restrictions on Husky. For instance, in 1972, Gulf wrote to Husky indicating it would not increase the product Husky could lift because Gulf did not intend to lift any more itself:

> "As regards Moose Jaw, the terms of our contract reflect the intent that supply at this location should be reciprocal with Lloydminster and we believe that the deal can only be of mutual economic benefit so long as this balance is maintained. Having already notified you of our own aim to stay with the basic 400,000 barrel entitlement next year we regret that we cannot justify supplying Husky with a larger volume than this and your estimate of 450,000 barrels is therefore not acceptable."
>
> (Document #138549, October 23, 1972, Husky)[105]

The same position was adopted by Gulf a year later — that Husky's liftings must be restricted to Gulf's withdrawals from Husky:

> "De Grandis [Gulf] stated that the asphalt volumes at Lloydminster and Moose Jaw must be reciprocal and suggested that the volume available at Moose Jaw be limited by Gulf's withdrawals from year to year at Lloydminster."
>
> (Document #138471, November 30, 1972, Husky)[106]

Gulf was not averse to using its ability to take extra product from Husky when it wished to discipline this company. In the following example, Husky recounted that Gulf had stated it was taking more product from Husky than it would otherwise have done because Husky had increased its liftings from Gulf:

> "3. We discussed the interpretation of Clause 5(a) in the asphalt processing agreement. Joe DeGrandis [Gulf] expressed his interpretation as being the intent of the original agreement and not necessarily the actual words that were used. He believes that the intent was that the volumes at Moose Jaw and Lloydminster would be reciprocal. This means identical to them, and *he admitted asking for additional asphalt from Lloydminster this year when he found out we were taking larger volumes from Moose Jaw.*"
>
> (Document #138439-40, June 26, 1972, Husky, emphasis added)[107]

Apart from revealing Gulf's reaction to an expansion of sales by Husky, this excerpt also demonstrates the implicit nature of agreements that were appended to the supply arrangements. The author of this document was questioned, and he confirmed the implicit understanding that had been reached on this matter:

> "Q. Sir, when I read here, 'not necessarily the actual words that were used,' am I correct in understanding that the agreement was reciprocal despite the fact that word was not used?
>
> A. That is right, this is my method of expression in this memo."
>
> (Testimony of Mr. Fink, General Manager Supply and Distribution, Husky, Calgary Hearings, 1975, p. 2303, Vol. XXI)[108]

Implicit agreement was also reached in the area of 'territorial exclusivity' or other restrictions delineating market limitations. The agreement between Gulf and Husky noted that supply would only be provided to satisfy demand in a "marketing area traditionally served" by the other. This was interpreted to mean product should not move to other areas without the consent of the supplier. Manifestation of the implicit agreement on this matter can be found in correspondence between Husky and Gulf. Gulf had trouble marketing its total allotments from Husky and received permission to move some of it outside of the "marketing area traditionally served" by Gulf. A letter from Husky to Gulf on this subject reads:

> "This will confirm the mutual arrangement we have made for 1972 on your asphalt requirements from our Lloydminster refinery. We accepted your reduction from the original demand of 400,000 barrels for the season to a revised demand of 341,000 barrels. It now appears that your actual requirements will only be 250,000 barrels.
>
> "The acceptance of your reduced volumes does not set a precedent for subsequent years nor can the underlifted product be made up in subsequent years. The shipments from Lloydminster to Calgary were outside the area traditionally served by Gulf from Saskatoon. Such deviation from contract relative to area was accepted for 1972 in a spirit of co-operation to aid Gulf in lifting contract volume. It must be emphasized that this 1972 approved deviation does not constitute continued approval or permission for deviation."
>
> (Document #138336, October 4, 1972, Husky)[109]

Similarly, a letter of the following year indicates that discussions continued with respect to mutually acceptable marketing areas. A letter to Gulf from Husky stated:

> "On October 4, 1972, we provided you with a waiver under the above agreement that would permit shipment of asphalt from Lloydminster to Calgary. This was considered to be outside the area traditionally supplied by Gulf as provided in the above agreement. We have not received a request for a similar waiver in 1973 but would like to have your estimate at this time if any area waiver will be required."
>
> (Document #138540, March 7, 1973, Husky)[110]

At the same time as Husky was stressing to Gulf the need for the latter to observe 'territorial exclusivity', it was acting in accordance with its interpretation of the understanding that had been reached on the observance of a division of markets. An employee of Husky wrote:

> "We are also honourbound to stay clear of the old Saskatoon marketing area of about 250,000 barrels."
>
> (Document #138704, March 1, 1973, Husky)[111]

When questioned on this, the Husky official attributed this statement to instructions that had been issued by management:

"Q. And in the same paragraph you write, in the last sentence:

'We are also honour bound to stay clear of the old Saskatoon marketing area of about 250,000 barrels.'

Why did you feel honour bound to do that, sir?

A. In our agreement; I guess you read this.

. . .

Q. Is there any reason why you should have stayed out of the Saskatoon market?

A. Absolutely none, it was written into the agreement according to what I was told.

Q. That you were to stay out of the Saskatoon market?

A. No.

Q. What were you told?

A. *I suppose leaving Gulf to market in the area that they were accustomed to market*, and the other problem there was the allocation by the Saskatchewan Government.

Q. Do you recall who gave you that advice in regard to the Saskatoon market?

A. No, not specifically; coming from upstairs.

Q. By 'upstairs' who do you mean?

A. Management."

(Testimony of Mr. Sanden, Manager of Asphalt Sales, Husky, Calgary Hearings, 1975, Vol. XXII, pp. 2432-3, emphasis added)[112]

Agreements and enforcement mechanisms are inseparable. In the case of implicit as compared to explicit agreements, enforcement mechanisms are all the more important because of the higher probability that they might have to be employed. In light of Husky's understanding of the agreement with respect to the "marketing area traditionally served" it is not surprising to find that it reacted sharply when it believed Gulf was not observing the terms of the agreement. Testimony indicates that Husky retaliated against Gulf when the latter moved product that had been received from Husky outside of the territory Husky considered to be Gulf's "marketing area traditionally served":

"Q. In 138705, sir:

'Maybe a few more points wouldn't do any harm. Please refer to page 8 of the agreement. Note the asphalt we produce for Gulf at Lloyd is designated for the 'marketing area traditionally served by Gulf from Saskatoon.' Just let me catch a gallon moving outside this designated area.'

Would you explain that a little bit?

A. I caught gallons moving out of that designated area and I retaliated.

Q. In what way did you retaliate?

A. I took business away from them."

(Testimony of Mr. Sanden, Manager of Asphalt Sales, Husky, Calgary Hearings, 1975, p. 2435, Vol. XXII)[113]

Husky was not unique in considering 'territorial exclusivity' to have been an implicit part of the product-supply arrangement. In the following document a Gulf official outlines the accounts Gulf would have to treat with caution because they belonged traditionally to Husky:

"*POUNDER EMULSIONS — MOOSE JAW*

Gulf Oil Canada is confronted with an unusual competitive situation relative to Husky asphalt sales. It seems possible that we may find ourselves accused of acting in restraint of trade by refraining from competing with Husky on certain business which, prior to 1972, was held by Husky and supplied by their own facilities.

"In Calgary for example we will find ourselves faced with the necessity of quoting higher prices to Chevron Asphalt to avoid taking this account which has historically been Husky's in Western Canada and supplied from Lloydminster.

"Similarly, in Moose Jaw the T.V. Pounder Company has been a Husky account and our present attitude is that Gulf Marketing should leave it severely alone pending some action by the customer.

c.c. Messrs. B.G.S. Withers — *Please destroy*
J.D. DeGrandis[1] *as soon as you*
have reviewed
this item.
J.W.U."

(Document #71766, November 15, 1971, Gulf, latter emphasis added)[115]

Any agreement can be broken. Because misinterpretations arise or because field marketing personnel make mistakes, the terms of an agreement may not be observed at all times. In the Gulf-Husky agreement there is evidence of this problem. Nevertheless, even when disagreements occurred, a solution was sought that would bring the interests of the two parties together. The following document illustrates how the maintenance of market shares and the observance of 'territorial exclusivity' could not always be observed. Equally important, it demonstrates Gulf's desire to revise the agreement to link market shares even more tightly than in the original arrangement. The following excerpt is from a letter written by Gulf's Calgary office to its Toronto office:

"YOU ARE AWARE THAT UNDER THE PRESENT GOVERNMENT THE LEVEL OF ACTIVITY IN THE SASKATCHEWAN MARKET HAS DROPPED CONSIDERABLY. AS A RESULT 'THE MARKETING AREA

1. The reply received from DeGrandis shows that he washed his hands of the affair— "...I would like to re-state that this is a Marketing or Refining matter and we, therefore, have no opinions on the subject" (Document #77906).[114]

> TRADITIONALLY SERVED BY GULF FROM SASKATOON' NOW GENERATES MUCH LESS THAN THE 400 MB ANNUAL VOLUME ORIGINALLY ESTIMATED. IN ORDER TO MAINTAIN THE NECESSARY LEVEL OF OFFTAKE FROM HUSKY, MARKETING WILL IN 1973 HAVE TO MOVE FIFTY PERCENT OF OUR ENTITLEMENT INTO ALBERTA. HUSKY ARE NOW OBJECTING TO OUR ACTIVITY IN CERTAIN NORTHERN AREAS INCLUDING EDMONTON, POINTING TO THE CONTRACTUAL PROVISION QUOTED ABOVE. *IN NEGOTIATION OF THE CONTRACT EXTENSION WE FEEL IT ADVISABLE THAT REFERENCE TO TRADITIONAL MARKET AREAS BE REPLACED BY ABSOLUTE VOLUMES WHICH SHOULD BE CLEARLY EXPRESSED AS RECIPROCAL. THE ALTERNATIVE WOULD BE TO REDUCE THE ESTIMATES BOTH SIDES AS APPROPRIATE TO REFLECT THE REDUCTION IN TOTAL MARKET WHILE MAINTAINING RESPECTIVE MARKET SHARES AS ENVISAGED IN CONTRACT CLAUSE 16.*"
>
> (Document #137412, February 14, 1973, Gulf, emphasis added)[116]

What is significant is not that Gulf and Husky had a misunderstanding on the meaning of the implicit terms of the agreement but that both continuously emphasized the need to observe terms that would have had the effect of restricting competition. Gulf emphasized the concept of reciprocal volumes and the need to agree on market share; Husky was insistent on the need to observe 'territorial exclusivity'. The disagreement was not over objectives, only over instruments.

(iii) The Impact of Restrictive Clauses at the Refinery Level

The examples given above illustrate the way in which restrictive clauses appended to product exchange agreements were utilized to restrict competition. The effectiveness of this and other arrangements, it has been argued, must be evaluated not only at the refining but also at the marketing level. Nevertheless, several pieces of evidence exist to show the impact of the restrictive aspects of the agreements at the refinery level.

First, there is evidence to show that the refiners were able to adapt their arrangements to changing circumstances rather quickly. The stability of the oligopolistic equilibrium was severely tested when market shares changed as the result of acquisitions — especially when the acquired firm was not integrated immediately and was maintained, ostensibly, at arm's length. For then, the refiners had to decide on the treatment to be accorded the subsidiary. The industry's ability to maintain an undisturbed equilibrium is demonstrated by the way in which one such case was handled. When a member of the Royal Dutch Shell group of companies acquired Canadian Fuel Marketers (CFM) the other refiners changed their treatment of CFM to accord with its new position:

> "Because of their Shell parentage, CFM have been meeting resistance from other majors who were previously prepared to deal with them as an independent."
>
> (Document #31029, June 29, 1971, Shell)[117]

There are statements by major firms that show the restrictive impact of the agreements. Imperial, for instance, in referring to a situation where it would exchange product in Alberta for product in Saskatchewan and Alberta, indicated that the arrangement would considerably restrict its ability to compete in the latter two areas:

> "We do feel, however, that our competitive position would suffer in such a situation, and our longer term sales in these two provinces could seriously deteriorate."
>
> (Document #140518, May 1972, Imperial)[118]

Shell also indicated that it faced some disadvantage where it did not have a refinery — even though it was able to obtain supply via exchange arrangements:

> "As you are probably aware, our participation in the Western Complex is not homogeneous and to some extent this has been influenced by location of our refineries. For example, our market shares are best in British Columbia and Manitoba [where Shell possessed a refinery], and the poorest in Saskatchewan and Alberta [where Shell did not possess a refinery]."
>
> (Document #36822-3, November 20, 1970, Shell)[119]

A similar statement is made by Shell in the following excerpt that emphasizes the reduced flexibility Shell enjoyed in areas where product was obtained from a supply agreement:

> "In Alberta, Saskatchewan and N.W.T. (MacKenzie Valley) Shell has limited market penetration in aviation fuels, asphalts, L.P.G.'s. Moreover, we have a relatively low market share in mogas and distillates [sic] products with still lower shares in commercial and industrial trade classes, since these products and markets are covered by exchange, with inherent reduced flexibility of supply/cost — availability — quality. This contrasts with B.C. and Manitoba, where Shell's market share *positions in most products and trade classes are higher*."
>
> (Document #31076, June 22, 1972, Shell)[120]

In addition, there are the statements as to the impacts of these agreements in a broader context. The statement by Shell that it found growth was generally impossible except via the acquisition route has already been quoted (Document #27882).[121] Of equal importance is Gulf's perception that by adopting a strategy of status quo in market shares, prices could be stabilized and improved:

> "By limiting our volume target to a fair share of the market we feel it should be possible to maintain or improve prices without having to disrupt the market by price-cutting."
>
> (Document #71248, undated, Gulf)[122]

A market share strategy, with all the attendant restrictions on supply agreements, was, therefore, seen as the means by which competition could be restrained.

(f) *Conclusion*

The refining sector provided the nexus where each of the majors was bound one to another. This section has described the way in which this was brought about. Discretionary power arising from refinery ownership was important to the process but not sufficient, in and by itself, to forge the links that were observed. This was not an industry that could be characterized as a number of separate local monopolies. Rather the system of refinery agreements among the majors served to magnify and to extend existing natural market power.

It is sometimes argued that exchanges between companies must benefit competition since without them the number of marketers in a region must correspond to the number of refiners. This argument may be correct if the product-supply arrangements are not so encumbered by restrictions that competition is made difficult if not impossible. Restrictions attached to product-supply arrangements can prevent competition that might otherwise result from the expansion of the number of firms operating in a market. If one refinery in a region is replaced through product exchanges by two firms but, because of accompanying restrictions, they act as one, then the restrictions serve to prevent the product-supply arrangements from improving and may actually undermine the competitive environment.

The issue that has been addressed in this section is the extent to which supply agreements were deliberately arranged so as to restrict competition. The section on information exchanges indicates that it was the intent of some firms to enter supply agreements in order to obtain information on the activities of others and thereby to exert ‘control’ over them. ‘Control’ was developed through the use of those arrangements which provided some type of market-sharing agreement. These took the form of clauses concerning reciprocal volumes, ‘normal growth’, and ‘territorial exclusivity’ restrictions. Not all of these took an explicit contractual form; some involved tacit understandings. Finally, the majors in accepting and requiring an ‘entry fee’ enhanced the effectiveness of the predatory policies that the marketing volume shows were employed downstream from the refining sector.

4. *Supply Agreements and New Entrants*

An oligopoly must solve two problems if a coordination of policies is to succeed in producing monopolistic conditions. In the first place, internal cohesion, once achieved, must be maintained. The previous sections outlined the way in which the refining sector arranged its internal workings so as to maintain

oligopoly stability. In the second place, an efficacious method of dealing with external threats must be devised. The way in which this was handled is dealt with here.

An oligopoly if it is to successfully protect the monopolistic conditions in which it finds itself, when faced with entry, will react differently depending upon whether entry is 'potential' or 'actual'. When a firm is only considering entry, such an oligopoly will generally want to adopt a posture that discourages or prevents entry.[1] When entry has occurred, the issue that must be decided by the oligoply is whether to continue to oppose the new firm or whether to adapt to it. Some oligopoly theories that deal with entry assume that the existing firms respond passively;[2] the also assume that the new firm, in some sense, remains separate from the original group.[3] Yet, once entry has occurred, it is quite possible that the optimal strategy from the point of view of the original group of firms is to make the new firm a member of the group.[4] In such a case, joint decision-making is extended to a wider set of firms and the monopolistic conditions are perpetuated.

This two-pronged approach to entry was adopted at the refinery level. The reaction of existing refiners to new entrants varied according to whether they were only potential entrants or whether they had already constructed facilities. In the case of potential entrants, entry was discouraged in one of two ways. If the identity of the potential entrant was such that the probability of entry was high, then the existing refiners offered product in order to delay entry to the refining sector. On the other hand, if the potential for entry was low, then the existing refiners generally refused to agree to a product exchange.[5] However, if the potential for entry suddenly increased, the existing refiners proposed or agreed to product-supply arrangements with the intent of decreasing the

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1. An exception could occur if the oligopoly felt that by permitting entry to one market it might buy a *quid pro quo* for entry by itself in another.

2. See for example John T. Wenders, "Collusion and Entry", *Journal of Political Economy*, Chicago: University of Chicago Press, (1971), pp. 1258-77 for an analysis of whether passivity is optimal.

3. See for example Wenders, *op. cit.* who treats new firms as not belonging to the original collusive group which is seeking to deter entry. Before entry has occurred, this is obviously the correct approach. After entry has occurred, it is not clear that it is always correct to do so.

4. When a predatory policy is suggested by the need to reduce the rate of actual entry from the pool of potential entrants, then the oligopoly may choose not to accept the new firm into the group. Evidence from the study of the marketing sector shows predation was adopted against those entrants to marketing who were non-refiners.

5. While a product exchange or a processing agreement might be refused, a product sale might still be made. The reason for this was that a sale involved higher prices than a processing agreement and, therefore, was less likely to lead to a disruption in the marketing sector.

incentive, which a new entrant might otherwise have had, to engage in price competition. In the latter case, the effect of the arrangements was the same as that described in the previous section — to tie the existing refiners together.

Several examples exist of national majors offering arrangements to other national majors in order to delay refinery construction. In 1962, Imperial considered supplying Texaco in order to delay Texaco's entry into refining in the Atlantic provinces:

> "...Imperial should consider supply arrangements with Texaco in order to delay construction of their refinery."
>
> (Document #94038, January 29, 1962, Imperial)[123]

Shell also considered an exchange with Gulf in order to forestall the latter from building a refinery:

> "If we and Imperial want to forestall B.A. from building in Winnipeg, we must provide them with sufficient capacity to economically meet their requirements."
>
> (Document #25195, September 6, 1966, Shell)[124]

It is significant that, in each of these cases, a national major was willing to accommodate another national major. For this was the group with the most likelihood of being able to enter the refining sector successfully. A policy of accommodation was also extended to smaller refiners for the same reason. Shell, in considering an exchange with Husky, noted that this company might build a refinery if it was not given supply:

> "Husky get the large advantage of leaning on a major company for long term supply at relatively predictable cost. However, if Shell can get the protection required for the uncertainties of the future and also make a good return on our capital, the deal would be advantageous to Shell as well. *If we do not cover Husky they will presumably go to Gulf, Imperial, or attempt to form a consortium of the small companies to build their own facilities.*"
>
> (Document #27158, July 27, 1973, Shell, emphasis added)[125]

Imperial used the same argument in evaluating the desirability of providing Pacific Petroleums with supply. In addition, Imperial emphasized that it wanted to prevent firms like Pacific Petroleums from building a refinery since Imperial's objective was to increase "control over spare capacity":

> "If Imperial were not to continue to be one of Pacific's major suppliers, we believe they have two feasible long term alternatives. The first is to enter into a supply arrangement with somebody like B.A. Such an arrangement would no doubt provide them roughly the same degree of market access as a similar arrangement with Imperial. The second alternative is to construct a small refinery and provide their own product supplies. Such an investment in Edmonton, for example, could be tied in to the proposed network product pipelines and provide them with low-cost transportation throughout the Prairies.

> "In setting out this second alternative, we have made the basic assumption that Pacific is not capital limited. If this assumption is valid, it would appear that the following factors would provide our motivation to continue to be a major supplier to Pacific Petroleum:
>
> 1. *We would defer construction of additional competitive refinery capcity [sic] in the Prairies. This would increase our degree of control of spare capacity.*"
>
> (Document #91875-6, October 8, 1968, Imperial, emphasis added)[126]

Thus, providing a firm, which would have otherwise entered the refining sector, with product supply was seen as a method of maintaining control over spare refinery capacity. In turn, maintaining this control and directing it only to responsible marketers would have served to reduce the degree of price competition downstream in marketing.

It was not necessary for a potential entrant to possess a refinery elsewhere in Canada for it to be classified as having a high probability of entry. Gulf, for instance, felt the United Farmers of Alberta (U.F.A.) could become a refiner. In evaluating a processing agreement with the United Farmers of Alberta, Gulf stated:

> "On the other hand, the U.F.A. account and volume is a fact of life and if the major oil companies do not negotiate seriously with U.F.A., it is conceivable that U.F.A. would enter into an agreement with Federated Co-ops and that U.F.A. would, themselves, become refiners."
>
> (Document #60249, March 16, 1971, Gulf)[127]

When Murphy first attempted to enter the market, Shell refused to supply it:

> "When Murphy first came to Quebec around 1962, Paul McDonald, still the boss man in Calgary, and Bill Seuren . . . called on Jim Courtright and myself to discuss their supply arrangement east of N.E.B. *At that time the company's attitude was negative, as we had strong, views against putting a competitor into business.* Our reply was to the effect that we simply could not cope with the request."
>
> (Document # 26247, June 29, 1971, Shell, emphasis added)[131]

It should be stressed that the majors' objection to supplying firms such as Murphy was based on their marketing policies. As the marketing section shows, the independents generally did not operate the expensive, high-priced marketing networks that the majors had spawned. By employing less expensive distribution networks, they were able to undercut the majors' prices and threatened the profitability of the majors' dealer networks. That these considerations were important in refusing independents product supply is evidenced by the following excerpt from a Gulf document. This excerpt discussed a proposed supply agreement with Murphy:

> "Further to your memorandum of the 2nd instant attaching a memorandum from Mr. D.J. Wright with reference to the above mentioned company. This would appear to be very attractive from a refinery thruput viewpoint, but all we need in Western Canada to make some marketing departments fall flat on their faces is to allow an aggressive price cutting marketer, such as Murphy, to become established on the Prairies."
>
> (Document #78597, April 7, 1970, Gulf)[132]

Thus the refiners followed a pattern of behaviour that made entry difficult; but, as has been stressed, once entry occurred the refiners turned to preventing competition from developing. The two-pronged nature of the policy is best illustrated by deliberations of certain majors in situations where the potential entrant did not fall clearly into either of these two categories.

Imperial's strategy for dealing with Ultramar's proposed entry into Quebec in the late nineteen sixties is outlined below. At the time, Ultramar was contemplating the construction of a refinery in Quebec. Two recommendations were made by Imperial. First, in an attempt to discourage entry, it was recommended that Imperial not agree to use any of the capacity of Ultramar's refinery that would be excess to Ultramar's own needs. Secondly, it was recommended that if Ultramar had committed irrevocably to construct a refinery, then Imperial should seek an arrangement. This strategy is outlined below:

> "First, in order to deter Ultramar from committing themselves to refinery construction we should under no circumstances give them any encouragement that we

would consider utilizing their capacity to meet our supply deficiencies. It may well be too late to accomplish this, but we might go so far as to offer to process for Ultramar in our expanded Montreal refinery.

"Second, conditional upon Ultramar having passed the point of no return — if and when they make an irrevocable commitment to construct their refinery and have firmly established the size — then we recommend that we consider domestic product supply as a base against which our proposed Montreal expansion is assessed."

(Document #88826, April 25, 1969, Imperial)[133]

A refusal such as this to deal with a prospective entrant created a barrier to new entrants. Because refineries of large size had to be built in order to achieve economies of scale, if an entrant was faced with a refusal by other firms to take part of the product, this meant either that an uneconomically sized refinery would have to be built or that an economically sized refinery would have to operate at rates which imposed a prohibitive penalty upon their operation. Since the majors could count upon one another for exchange arrangements, they would not suffer this same penalty. In short, the need for potential new entrants to build large-scale refineries, in conjunction with the refiners' strategy of refusing to enter into supply agreements with potential new entrants who were not majors, would have acted as a barrier to entry into refining for this class of firm.

Shell took a similar view to Imperial on the attitude to take toward the entry or expansion of any new refiners. When the Newfoundland Refining Company (NRC) announced the construction of a refinery in Newfoundland, Shell considered entering into a supply arrangement with it. Of interest is Shell's objective: to obtain supply from NRC by a straight processing or purchase agreement rather than via an exchange which would give NRC access to the Montreal market:

". . . *we have what appears to be an attractive potential alternative for Maritime supply through an arrangement with Newfoundland Refining Company.* The latter may involve an exchange against Montreal, but *our objective is a straight processing or purchase arrangement in order to keep Newfoundland Refining out of the Montreal market.*"

(Document #41320, February 7, 1973, Shell, emphasis added on last sentence)[134]

However, Shell noted that if NRC (Shaheen) seemed likely to build a refinery in Montreal, then Shell's policy should be reversed and product should be offered this company in Montreal in order to provide Shell with control over the newcomer:

"It occurred to me that, assuming Shaheen is going to build in Montreal, we should now reverse our policy of buy but no exchange. In other words, we should negotiate with Shaheen on the basis that we will supply him at Montreal with the understanding that he will invest his money in the Maritimes in plant at Halifax/Moncton or wherever, where we could take the product back. *This would reduce his*

> *flexibility in the Montreal area and certainly provide us with a knowledge of his intentions and a certain degree of control*, as well as an alternative to Imperial Oil in the Maritimes."
>
> (Document #27320, February 9, 1973, Shell, emphasis added)[135]

All of the policies described in this section would have had the same effect. They would have served to put upward pressure on prices. This is shown in the following Gulf document that deals with the effects that reduced entry would have on product prices:

> "Our reasoning, basically is that if we can deter refiners from expanding by offering processing capacity out of our own facility from 1975 onwards we not only tend to keep the West Coast sector of the industry in a tight supply/demand balance with strong product price levels..."
>
> (Document #78292, October 26, 1972, Gulf)[136]

New entry was, therefore, to be discouraged because of the effects it would have on prices. Imperial described the effect of one bout of entry that occurred in the early nineteen sixties:

> "Product prices both in Ontario and Quebec have deteriorated consistently over the past five years due to three principal factors:
>
> 1. Extreme competition in wholesale business as a result of new refiners breaking into the market and the whip-sawing effect of large-scale buyers — the latter being an increasingly important element."
>
> (Document #118722, June 7, 1962, Imperial)[137]

The result of entry in the early nineteen sixties, as the volume on marketing demonstrates, was the development of an independent sector whose growth was countered by the majors by the implementation of disciplinary, predatory pricing schemes. It must be stressed that these independent marketers did not initially penetrate the marketing sector because of access to product at 'distress prices'. Their success lay primarily in their lower wholesale and retail costs. In turn, refinery competition at this time was effective, not because it provided product at 'distress prices', but because it provided these marketers with access to product that they would not otherwise have had. This suggests that the stimulus to competition arising from refinery construction came not because product was dumped at excessively low prices but because it provided product to a portion of the marketing sector — the independents — which normally had difficulty in obtaining supply. When this sector was able to obtain supply, it was able to expand because of its lower marketing costs and, in turn, this led to the outbreak of price competition.

The experience of the early nineteen sixties indicates that the impact of anti-competitive practices at the refinery level varied over time. But then, this

is to be expected in an industry where the environment is changing. The anti-competitive aspects of the agreements made in the refining sector may be measured in terms of the degree to which they reduced the impact of a changing environment on competition. Measurement of the degree to which competition was constrained requires an evaluation of the extent to which both the intensity and the duration of competition were reduced.

It is not that entry to the refining sector was eliminated throughout this period, rather that it was constrained beyond what was in the public interest by the type of refinery arrangements entered into by the majors. This constraint was placed both on the rate of entry and on the potential for independent action once entry had occurred. In the first case, the existing firms developed a strategy of refusing access to product to those who would not abide by the established high-cost marketing policy. In the latter case, existing refiners developed a strategy of supplying new entrants or those who offered a credible threat of entry in such a way that the dominant refiners continued to 'control' the industry and to exercise a dampening effect on competition.

In summary, the majors developed a strategy of using the discretionary power that they possessed at the refining level in a selective fashion so as to maintain oligopoly discipline at the marketing level. To do so, refinery capacity beyond that which would maintain strong product prices was discouraged (Document #78292).[138] Of course, should agreements and practices have been aimed only at preventing spare capacity and unnecessary expansion, then they might not have detrimentally affected competition. But a desire to restrict capacity, as was illustrated above, could have been aimed either at a reasonable or an unreasonable restriction on capacity. The reasonableness of the actions of the industry's participants must be evaluated in terms of accompanying actions and objectives. When this is done, it is evident that the refiners attempted to constrain competitive forces. The intent to achieve "control of spare capacity" found in an Imperial document (Document # 91876)[139] indicates this firm was attempting to sustain and to create a dominant position for itself. The manner by which such power was intended to be used is illustrated by Shell's objectives — to reduce the flexibility of and to 'control' other firms (Document #27320).[140] Finally, the objective of attaining upward price pressure must be interpreted in light of the discrimination that was practised against firms that threatened the high-cost, high-priced distribution network of the majors. The desire to keep out other firms was not simply one of not wanting to supply others, for supply was readily granted to some. As Gulf indicated, they did not want to assist "aggressive price cutting" marketers in getting established (Document # 78597).[142] It is for this reason that refinery policies were inimical to the public interest. The next section will elaborate on the way in which refinery policies were aimed at restricting the independent marketing sector.

5. *Selective Supply and the Restriction of Supply to Price Competitive Marketers*

(a) *Introduction*

Each of the two previous sections has concentrated upon the way in which arrangements among refiners served to join their interests together. To some extent, this was no more than the natural or unavoidable outcome of rationalization agreements at the refinery level. Nevertheless an appreciation of the degree of interdependence so created is important; for interdependence contributed to the stability of the tacit understanding that governed the behaviour of the industry in the marketing sector. In addition, a close examination of the intent of the majors and their actions shows that refining arrangements were deliberately encumbered with conditions that were meant to restrict competition. The collection of information, the intent to control lesser firms, the imposition of an 'entry fee', the use of restrictions on downstream growth are not characteristics that would be expected normally from a competitive market.

The previous description of the refiners' reaction to entry also shows an intent to influence the performance of the marketing sector. It demonstrates that a deliberate attempt was made to ensure that arrangements among existing members of the oligopoly were extended to new entrants. In addition, it indicates that an attempt was made to keep certain undesirable competitors out — those who generated price competition were discriminated against. Further evidence on this attempt to use the discretionary power that existed at the refinery level to discriminate against competitive marketers is developed in this section. In contrast to the firms considered in the last section, the marketers considered here generally offered little threat of entry to refining. They did, however, provide the majors with competition in the marketing sector. The marketing segment of this study demonstrates that these marketers did not offer unfair competition. It was not in their acquisition costs that they had an advantage over the marketing divisions of the majors. Rather, it was in the lower level of their wholesale and retail costs that they possessed an advantage. Therefore when the refiners employed the discretionary power that they possessed at the refinery level to discriminate against this class of marketer they were extending the monopolistic conditions that existed at the refinery level to the marketing sector.

(b) *Discretionary Power at the Wholesale Level*

The majors adopted analogous predatory policies at the marketing level as well as price discrimination at the refinery level in order to protect their marketing networks and to enable them to charge inordinately high prices throughout most of the post-war period. The success of this policy is outlined at length in the chapter that deals with marketing. The complementarity of the

two instruments has meant that the way in which wholesale policies were actively used during the brief periods when predatory pricing was employed is more appropriately included in the marketing sector. Accordingly a section was included therein. Notwithstanding this, these episodes also serve to illustrate the manner in which the majors marshalled their forces at the refining level to support their activities in marketing. As such, they shed light on the reasons selectivity of supply and price discrimination were used against the independents.

Normally, the policies followed at the refinery level were sufficient to maintain discipline in the marketing sector. But on two occasions since the early nineteen fifties, the independent marketers obtained sufficient supply to expand at the expense of the majors. In each case, the majors looked both to their ability to influence wholesale prices upwards and to predation at the marketing level to discipline the independents.

The first major outbreak of price competition occurred at the beginning of the nineteen sixties. When the industry leader — Imperial — was faced with competition from independents at this time, it attempted to increase the wholesale prices that the independents paid. In discussing its attempts to lead retail prices upward, Imperial noted:

> "... Imperial tried to increase the price of gasoline at the retail level. While many companies followed, the price simply did not hold and it was convincingly demonstrated that retail price action cannot be effective so long as wholesale discounts to resellers and tender accounts remain at the present level. ...
>
> "*Under the circumstances, the only effective solution is to endeavour to strengthen the whoesale [sic] price structure — that is, reduce the number and size of discounts to the private brands*, commercial consumer, and other consumer category who buy in quantity on a non-reseller basis. ...
>
> "*The real problem is to determine how the whoesale [sic] price structure can be strengthened.*"
>
> (Document #118725-6, June 7, 1962, Imperial, emphasis added)[143]

Clearly evidenced in this quotation is the understanding that the retail sector could not be stabilized without control being exercised over wholesale prices.

Ultimately the majors succeeded in constraining the independents and pushed wholesale/retail margins to high levels by the end of the nineteen sixties. But independents then caused price competition to break out once again. In 1970, Gulf observed that the greatest threat to the majors' branded system came from independents:

> "*CURRENT ISSUES REGARDING THE RETAIL CLASS OF TRADE*
>
> ...
>
> "The major issue is the apparent erosion of the brand system of retail marketing...

> "a) At the present time, the 'non-refiners' are increasing their share of the retail gasoline market at a faster rate than the market is growing."
>
> (Document #73920, 1972, Gulf)[144]

As in the earlier period, it was recognized that both marketing and refining policies would have to be used against independents if their growth was to be curtailed. Gulf, for instance, pointed out that a coordinated approach between the department responsible for refinery sales and the marketing department was required in order to augment the "aggressive approach" that the marketing department had adopted against private branders:

> "RE: COORDINATED MARKETING APPROACH *TO SALE OF SURPLUS CAPACITY*
>
> "Over the last several months there have been a number of efforts made to try and establish the basis for arguing against the sale of surplus capacity to other small refiners or Private Brand Distributors who are or may affect some portion of our own marketing activities. . . .
>
> . . .
>
> "Private Brand Distributor Study — Phase I — Prairies also did not evaluate the discounted cash flow loss to an infinite period in the future from loss of motorist business to the private branders. Therefore, I do not feel that we have fully measured the impact of doing business with private branders. *The outcome of the presentation did open up one opportunity for Marketing to confront S & T with the job of controlling their customers in the PBD market if we were to take an aggressive approach with the private branders.*"
>
> (Document #71695-6, October 13, 1971, Gulf, emphasis added)[145]

The aggressive approach, taken by the marketing departments of all the majors, involved the widespread implementation of predation. As the above quotation recognized, the effectiveness of this policy depended upon whether product could be denied the price marketers or, at least, whether the wholesale price that this sector paid could be forced upwards.

What is equally important is the fact that Gulf recognized that its discretionary power at the refinery level could be used to force up wholesale prices. In commenting upon its position as the only refiner with surplus capacity on the Prairies, it noted that this would permit Gulf to move up wholesale relative to retail prices:

> "*STRATEGIC CONSIDERATIONS ON SALES OR SUPPLY TO OTHER RESELLERS*
>
> "Gulf Canada is in the favourable position on the Prairies of being the only refiner with surplus capacity until the new Imperial refinery is complete in 3 years time. Gulf should have an opportunity therefore to influence this market to a degree that is not possible elsewhere."
>
> (Document #75334, January 1972, Gulf, emphasis added)[146]

Shell was in an analogous position in Ontario. Because of its supply position it felt it could strengthen wholesale prices:

> "In Ontario, we continued to be plagued by a strong growth in private brand retail gasoline sales resulting from sales of surplus gasoline at excessive low prices and in generally depressing effect on our retail prices. Furthermore for the same reasons wholesale prices have not been improving at the same rate as dealer tankwagon posting.
>
> "It would appear that if Gulf and BP are near capacity and Esso continue their past reluctances to sell to Texaco (especially at low prices) our principal competitor may be Sun. *If there was ever an opportunity to tighten up the Ontario market, this should be it.*"
>
> (Document #31039, February 16, 1972, Shell, emphasis added)[147]

Both of these quotations demonstrate that when refinery capacity was so distributed that one or two companies had 'control of space capacity', they felt they could act unilaterally to move prices upward. This explains, in part, Imperial's desire to have "control of spare capacity". If it possessed "control of spare capacity", Imperial could also have acted to maintain an upward pressure on prices. When this was not the case, more widespread harmonization of wholesale refinery policies had to be achieved. The next section demonstrates how this was accomplished during the periods when control of excess capacity was not concentrated in as few hands.

The episodes of price competition in the early nineteen seventies were unusual in that they were characterized by short but sharp outbreaks of price competition on the retailing side. But these episodes were not unique with respect to the general type of policy followed at the refining level. What changed during the short periods of price competition was the intensity of the application of the disciplinary policies followed in the refining sector. With the sharp decline in retail prices, the majors chose to introduce more intense disciplinary policies in marketing in order to constrain or eliminate the independents; but in the refining sector, they only tightened up the policies that generally had served so well to contain and to prevent outbreaks of competition during the previous two decades.

As such, these episodes demonstrate two facets of behaviour that were more widespread and that were not constrained just to these brief interludes of competition. First, the majors attached importance to the stabilizing effect of their wholesale policies at the refining level. Secondly, they recognized that if sufficient discretionary power existed, actions could be envisaged that would force up wholesale prices and protect their marketing margins. Both of these can be found in various guises in the general supply policies that were used for independent marketers. These are described in the next section.

(c) *Selective Supply to Independent Marketers*

The major refiners adopted policies, in one form or another, aimed at independent marketers who tended to disrupt the established majors' price levels. Generally, selective supply practices were employed to discriminate among marketers on the basis of their adherance to the high cost, high price marketing strategies adopted by the majors. The major refiners' strategy was to supply only 'responsible' marketers. This is exemplified by the policies that were formulated with regards to direct sales. It can also be found in considerations that were used to determine acceptable processing partners. Finally, it is apparent in the policies used to ensure that 'responsible' marketers who received product did not resell to the competitive element in the market. Each of these will be dealt with in the following sections.

(i) *Direct Sales and Processing Agreements*

While all the majors adopted policies that served to restrict the growth of competition from the independent sector, each company adapted its own variant to the particular situation in which it found itself. For instance, Imperial, as the market leader and the most self-sufficient firm at the refinery level, could best afford to adopt the policy of avoiding sales to the independent sector.

Imperial considered a strong wholesale price structure as essential to the maintenance of stability in the retail sector (Document #118725-6).[148] In order to accomplish this, Imperial limited its participation in this market. The following excerpt implies that Imperial quoted prices that kept it out of this market. Explaining its lack of participation in this segment, it noted:

> "*Imperial are not predominent in the wholesale gasoline market in Canada.* Generally speaking if we want business, we have to price at the competitive levels established by Gulf, Shell and Sun in the Ontario market, and majors in the other regions of Canada."
>
> (Document #119396, February 21, 1972, Imperial, emphasis added)[149]

It is evident that Imperial did not want jobber business in Ontario; for it did not price at the levels established by the other Ontario refiners:

> "*In the past, our policy has been to quote jobber business twenty points above the high of 17.0 c.p.g. in Toronto. Naturally we have hardly penetrated the market.* If, however, we desire to achieve our rightful share of this market, which could be based on our refinery capacity versus Industry in Ontario, we would have to look at prices in the 16.75 c.p.g. range."
>
> (Document #119397, February 21, 1972, Imperial, emphasis added)[150]

As a result of its deliberate pricing policy, Imperial supplied only about 5 per cent of the volume of gasoline made available to the resellers in Ontario (Document #32955).[151] Its market position in Quebec, and the reason for it, were the same as in Ontario:

> "The current relatively narrow spread between crude and product prices could be a factor influencing competition's market selectivity. *Another factor influencing our declining share of the motor gasoline market [Quebec] is our decision not to participate in supplying the private brand segment.*"
>
> (Document #123676, February 7, 1969, Imperial, emphasis added)[152]

Imperial was also not predominant in the Prairie reseller market. In 1970, Imperial supplied — both directly and indirectly — only 11 per cent of the total private brand retail volume sold on the Prairies. In comparison, 65 per cent was supplied by Gulf, the other significant refiner in the Prairies, and 14 per cent by Shell who had a small refinery in both Alberta and Manitoba (Document #71480).[153] Gulf observed:

> "It is understood that the United Farmers of Alberta contract is the only private brand deal of any consequence that Imperial has in Alberta."
>
> (Document #60247, March 16, 1971, Gulf)[154]

Imperial's selectivity had the effect of restricting competition in the retail market. For the type of account Imperial was willing to supply — United Farmers — was characterized by Gulf as not being very aggressive. Gulf documentation indicates that the United Farmers were stable, non-aggressive marketers:

> "*United Farmers are relatively stable marketers* with an historical growth rate of only 3.1 per cent and *it would be preferable to deal with them rather than with an aggressive refiner who might move the product by discount pricing.*"
>
> (Document #60241, March 16, 1971, Gulf, emphasis added)[155]

This suggests that price competitors were deliberately not supplied by Imperial. Consistent with this interpretation is the fact that when Imperial found itself supplying an account that did generate competition, it re-evaluated its decision to supply this firm. In the late nineteen sixties, Imperial had a B.C./Prairies exchange with a small refiner, Pacific Petroleums.[1] Imperial's reluctance to supply aggressive marketers is illustrated in its review of this arrangement with Pacific Petroleums. In 1968, Imperial expressed concern:

> "Imperial is currently in the process of renegotiating a purchase/sale arrangement with Pacific Petroleum which has been in effect now, in one form or another, since 1958. *It is becoming increasingly evident that Imperial is a major supplier of a rapidly growing brand in the Western provinces; and that perhaps Imperial should be considering the possibility of either a long term direct supply arrangement with Pacific, or discontinuing supply entirely.*"
>
> (Document #91880, undated, Imperial, emphasis added)[156]

Pacific Petroleums, in an attempt to protect its supply source in the Prairies, assured Imperial that it would not continue its past growth rate, that it

1. Pacific Petroleums had a 10,900 barrels per day refinery in Taylor, B.C.

wanted to "create a solid image in the market place", and that it would not supply non-brand jobbers. An Imperial document recounted Pacific Petroleums's assurances on this matter:

> "(b) New Contract Possibilities — This subject was covered partly by comments in (a) without detailing the firm interest Imperial has in a new agreement. In exploring possibilities, *Mr. Harfield [Pacific] indicated that Pacific would experience low growth rates in the immediate future* due to consolidation in line with their overall plan. He expressed a desire to have the right to products at all existing locations, although developments beyond Fort William would not take place immediately. *They are not interested in supplying non-branded jobbers and wish to create a solid image in the market place.* He indicated that they were forced into one retail outlet in Montreal due to their property purchase and were receiving supplies from Texaco for it."
>
> (Document #88757, February 22, 1968, Imperial, emphasis added)[157]

That Pacific Petroleums perceived a need to make such assurances is consistent with its understanding that an aggressive stance in the market place was unacceptable to Imperial. this was the message that Imperial had conveyed to Shell in the Maritimes. The result of Imperial's deliberations on the Pacific Petroleums exchange was a decision to phase out supply to this firm over a three-year period; however, it proposed to continue purchasing its Taylor, B.C. requirements from Pacific Petroleums (Document #91874).[158] This example, then, provides a second illustration of Imperial's exploitation of its power to discipline aggressive behaviour in marketing — the first being provided by events surrounding its renegotiation of its exchange agreement with Shell in the Maritimes.

Thus, Imperial implemented a policy of selective distribution by intentionally supplying only a limited number of private branders. Other firms, like Gulf, were building capacity in order to attain refining capacity across Canada and could not afford to cut off the independent sector completely. Instead, they attempted to select, in as careful a fashion as possible, their customers so as to encourage oligopoly stability. When the growth of the private brand segment threatened branded sales, they moved to tighten already established policies that restricted supply to 'responsible' marketers. The Gulf and Shell documentation to follow, therefore, illustrates the way in which selectivity of supply was applied to reduce competition during these periods.

Shell based the desirability of supplying independents on the same criterion used by Imperial. Shell followed a practice of supplying only 'responsible' private branders. It adhered to this practice throughout the nineteen sixties and nineteen seventies but emphasized it in the early years of each decade — the two periods during which the independent marketers made rapid inroads into the retail gasoline market.

That Shell also used the criterion of responsibility to choose processing partners is shown by the following example. In 1963, Shell considered a

processing agreement to cover Murphy's Ontario and Quebec requirements. A letter was sent from the Shell Executive Vice-President to the Division Managers of Marketing of the Central and Eastern Divisions requesting the following information on Murphy and the market area in which it participated. This letter requested:

> "Numbers, locations, *volumes and prices relative to the surrounding market of retail gasoline outlets.*
>
> "A report of their activities in the fuel oil and bunker market, with particular reference to their pricing structure.
>
> "Your comments on the probable effect on your gasoline and fuel oil dealers if they picked up supplies at our plants (other than refinery locations) and also if it became known that we were supplying at our refineries."
>
> (Document #26270, September 26, 1963, Shell, emphasis added)[159]

In the letter to the Division Managers, the Executive Vice-President passed on the following information that he had received from the Vice-President of Transportation and Supplies:

> "*Murphy maintain that their objective is to market at the price level of the majors.* They say they are doing this currently at their stations in the Montreal area and are securing a good volume per station. With respect to Ontario, they say that whereas Vigor [Murphy acquired Vigor] supported the cut-rate fuel dealers, this situation has been cleared up. With regard to their gasoline outlets, the objective is to sell at majors' price level, but they are not achieving this as yet.
>
> "We, at Head Office, are preserving a completely open mind on Murphy, who while not refining in this country, have a considerable marketing activity here."
>
> (Document #26271, September 26, 1963, Shell, emphasis added)[160]

Once information had been collected, the Executive Vice-President wrote to the individual in charge of such arrangements — the Vice-President of Transportation and Supplies — telling him that Shell should not process for Murphy:

> "It is our firm opinion that we should not make any supply commitments to Murphy.
>
> "If you should wish, I would be pleased to discuss the marketing implications of any such arrangement with you."
>
> (Document #26265, October 9, 1963, Shell)[161]

Shell did not, at the time, make a supply commitment to Murphy. This example also demonstrates that Murphy thought it necessary to assure Shell that its objective was to price in line with the majors in order to obtain supply. To the extent that smaller firms recognized the implicit or explicit constraints that were imposed upon them by this requirement, competition would have been reduced.

In 1973, Murphy approached Shell once again for a refinery agreement. In the interim, Murphy, along with Golden Eagle and the independents,

were reported to have put pressure on the established majors in the Eastern Complex market (Document #26858).[162] It is not surprising, therefore, that Shell's Marketing Department once again disapproved of processing for Murphy:

> "We understand that a process arrangement with Murphy — 3000 bbls/day — is worth $1MM per year to MTM, incremental since the capacity is already available and surplus to Marketing's tabled demand.
>
> "There are some concerns which must be surfaced, and at least one alternative to be examined.
>
> Concerns:
>
> (1) Murphy is known to be in a 'hold' position on capital investment in its Marketing (read Retail) sector;
>
> (2) *Murphy doesn't have an investment of any size in S/W Ontario, . . .*
>
> . . .
>
> (b) . . . *Murphy is defined as a 'price' marketer, and will continue to be a part of keeping the eastern Ontario market depressed.*"
>
> (Document #42718, February 21, 1973, Shell)[163]

Shell Marketing was opposed to processing for Murphy because Murphy was a "'price' marketer". It went so far as to recommend that Shell export its surplus product to the United States or leave its refinery under-utilized instead of processing for Murphy (Document #42719).[164] Since documentation indicates that Shell did, in fact, refuse to supply Murphy via processing (Document #27094),[165] this example illustrates another case of a major refusing to supply a price aggressive competitor.[1]

While this example relates to Shell's selectivity with regards to processing arrangements with independent marketers, Shell also adopted similar policies with respect to direct sales to marketers in the early nineteen seventies. In a paper entitled "Shell Canada Gasoline Objectives and Strategies", it was stated that supply should only be provided to "'responsible' marketers":

> "Discussion reaffirmed that *in the unbranded gasoline market at the refining rack we should concentrate determinedly on customers who had substantial own investment at stake and who, by way of this investment and other factors such as quality image, could be considered 'responsible' marketers.*"
>
> (Document #34370, December 13, 14, 1971, Shell, emphasis added)[166]

Mr. Williams, an official of Shell, has explained who the "'responsible' marketers" were:

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1. The volume on marketing indicates that Shell did make a decision at this time to reduce output or to export it so as to withdraw supply from the independent sector.

"I think I would have to classify them as those companies — *it would include the majors, but it would also include those companies that have invested heavily in their retail operation and are interested in making a return on their investment.*

. . .

"Simpsons-Sears, Canadian Tire, they are a responsible buyer, any department store regionally and I am not familiar with all the names."[1]

(Testimony of Mr. Williams, Vice President of Public Affairs & Corp. Planning, Shell, Toronto Hearings, 1975, p. 350, Vol. III; emphasis added)[168]

At the same time as Shell was restricting supply to the price competitive marketers in the early nineteen seventies, it was also setting up its own second brand network as a predatory instrument.[2] The following excerpts emphasize the joint nature of Shell's policies in this area:

"Retail mogas sales are under increasing pressure from unbrandeds in the key Ontario and Quebec markets and retention of market share is planned through continued diversification, *sales to responsible private brands* and development of the Shell owned Pribrand network. *Dependence on 'deep discount' supplies will be avoided.*"

(Document #44727, January 27, 1972, Shell, emphasis added)[169]

"In motor gasolines, our current objective is to maintain our 17% market share.

"Our strategy to maintain objective market share, as presently stated, is:

— continued development of Shell branded outlets at about historical levels, but with added emphasis on diversification such as 'self-serve', 'car wash', tie-ins, etc.

— expansion of the Shell-owned Concubine/Pribrand network.

— *sales to responsible Private Brand Marketers like Simpsons/Sears, The Bay, etc., who have a substantial investment in the market.*

---

1. It is important to note Shell's definition of "responsible" marketers. According to Shell, the department stores were "responsible". An examination of the supply arrangements between Shell and two of these marketers — Zellers and Gambles — reveals that Shell effectively controlled the retail prices of these large unbrandeds; thus they were less competitive than the other private branders. The contract between Shell and Gambles Limited in Winnipeg (Document #34672-88)[167] provides an example of such an arrangement. Under the terms of the contract, Shell supplied gasoline to Gambles on a consignment basis (clauses 2(a) and (b))—Shell set the pump price and based Gambles' commission on it. For instance, the commission was x¢ per gallon if the retail price established by Shell was, in Shell's judgment, "normal" for the relevant trade area; if "sub-normal" retail prices were established, Shell absorbed the first one cent of the "sub-normality" and shared any further "sub-normality" equally with Gambles.

2. This matter is developed at greater length in the marketing volume.

— *limiting* sales to the suppliers of the *'Deep Discount' or 'Black Flag' private brand operators, currently upsetting the market, to situations where temporary surplus supplies must be disposed of.*

"*We want to avoid becoming dependent on wholesale sales to the suppliers of 'Deep Discount' outlets because* of the uncertainties of the market and *the adverse effect it has on our Branded sales.* It is our preference to obtain our share of the 'Cut Price' Retail Market through expansion of our own Pribrand Network as necessary to maintain overall market share."

(Document #30648, May 1972, Shell, emphasis added)[170]

As a result of these considerations, Shell, when competition became more intense in the early nineteen seventies, developed its own second brand network and began to withdraw supply from that sector which it classified as being irresponsible.

An example of a more specific instance of Shell's policy in this area is provided by the following communication from the Manager of the Eastern Marketing Region. He recommended that Shell refuse to supply three unbrandeds in Ottawa — Martin, C.F.M. and Gasex. These three firms, he noted, were pricing as low as 34.9 cents per gallon — some 16 cents per gallon below the majors' established pump price. At the same time, he recommended that Shell's second brand network in Ottawa should be expanded:

"Our Retail attitude towards the selling of unbranded Mogas in Ottawa is in a development stage. Currently, we have three outlets which should produce 1.2 MM gallons in 1972.

"The market is complicated by the fact that all pipeline plant companies — save Esso — are supplying unbranded mogas at prices which allow pump prices as low as 34.9 c.p.g. (see clipping).

"*I firmly believe that we should withdraw from supplying each of Martin, C.F.M. and Gasex at Ottawa* — with the timing being only a matter of how quickly Retail can gear up its operation (which I suggest will be not less than 10 outlets in Ottawa/Hull and environs).

"In the meantime I regard my position as the meaningful focal point on this issue and request that *all* [emphasis in original] decisions on supply, volume or price (including changes) be reviewed with me before any decision is taken."

(Document #34352, December 6, 1971, Shell, emphasis added)[171]

When the Manager was questioned on the reasons for his recommendations, he admitted that the policy was based on the competitive pricing practices of Martin, C.F.M., and Gasex:

"Q. I am wondering about the reason for your recommendation that supply be withdrawn? What was your reason?

A. Pricing in Ottawa was taking volume from our branded service stations.

Q. That is Martin, C.F.M. and Gasex—-

A. And all others like them.

Q. That is the people who were discounting quite heavily, you mean?

A. Yes.

Q. And this discounting, heavy discounting, was taking away from the volume of your branded dealers in Ottawa?

A. That is correct."

(Testimony of Mr. A.G. Seager, General Manager of Marketing, Shell, Toronto Hearings, 1975, p. 123, Vol. I)[172]

During the height of the outbreak of competition at this time, Shell shifted to Head Office all authority on sales to the independent sector. This would have ensured that as little product reached irresponsible price competitors as possible. The following excerpt is taken from the notice that Shell's Head Office sent to regional managers informing them of the change and the reason for it:

"Sales of gasoline to unbranded jobbers, trade class 020, are to be referred to Head Office for approval. This is in recognition of the potential impact on our retail business, and the general differential between this trade and consumer accounts."

(Document #33029, August 18, 1972, Shell)[173]

Part of Shell's policy involved the compilation of a list of preferred independent customers. Customers were ranked according to Shell's perception of the extent to which they were 'responsible'. For example, the following ranking was sent to regional managers and the Coordinator of Wholesale Sales:

"A subsequent discussion with J.P. Callum confirmed the Region's preference of TC 020 customers as follows — *in descending order of investment/responsibility in the marketplace*:

Mogas	*Distillate*
Suny's	C.F.M.
Natomas (Premium)	Neal
Neal (Arrow/Total)	Roy-L
Roy-L	
C.F.M.	

Will you please ensure that we respond to that preference in our offerings of surplus product to the independents."

(Document #33541, June 19, 1973, Shell, emphasis added)[174]

In summary, Shell's selective policy was adapted to the degree of price competition existing at any one moment. Generally, Shell attempted to restrict supply to those firms which did not threaten the majors' branded structure. When price competition broke out, Shell tightened its policy. The examples of

the early nineteen seventies show that Shell developed a list of preferred customers and began to withdraw supplies from those who were providing the most price competition. This was conceived of as an integral part of the second brand strategy that was adopted in marketing — a policy whose predatory intent is described in the marketing volume. Shell's selective supply strategy, therefore, like its second brand strategy, was designed to bring about an increase in retail prices.

Gulf's behaviour during this period closely paralleled that of Shell. Gulf had adopted a general policy of either not supplying independents or supplying them on terms that would control their ability to discount. The latter was achieved by the implementation of a systematic form of price discrimination. Like Shell, when the independents began to expand in the early nineteen seventies, Gulf intensified its efforts at the wholesale level to control the independent sector.

Gulf recognized that its policy at the refinery level had to be formulated carefully because of the influence that independent marketers had upon the market. For instance, in 1968, Gulf noted that special sales to "certain resellers" would depress prices, while special sales to major refiner-marketers would have little effect on prices:

> "Mr. Clendining indicated that Special Sales to major refiner-marketers have little effect, while sales to certain resellers have the result of setting the market price."
>
> (Document #66143, October 3, 1968, Gulf)[175]

Gulf, therefore, carefully evaluated proposed product-supply arrangements in terms of their effect on the branded market. The following excerpt outlines objections of the Marketing Department to a request from Nepco for a processing agreement — objections which were based primarily on the fact that Nepco was a price cutter:

> "The Marketing Department would not be in favour of Gulf Canada entering into a processing agreement with Nepco at Montreal for the following reasons:-
>
> . . .
>
> ". . . the proposed agreement would provide Nepco with a guaranteed source of product supply in the volumes and with the product specifications required in the market and would provide them with the stability which they require for the future development of their business. It would also relieve them of operating expenses and capital investment which they now incur. Their overall competitive position would be substantially improved.
>
> . . .
>
> "3. *The supply of product to Nepco is counter to our program of increasing the general price level wherever possible. Nepco lead the way in price cutting and*

> *are probably the most irresponsible element in the market.* This applies to sales through dealers and to fuel oil jobbers."
>
> (Document #75642-3, April 13, 1970, Gulf, emphasis added)[176]

Gulf's actions extended beyond just a refusal to enter processing arrangements with price competitive firms. Direct sales also were rejected when they were perceived to lead to price competition. For instance, Gulf refused Martin Petroleum supply for this reason. A Gulf official recounted:

> "He [Martin Petroleum] is also the cause of the current depressed prices in that city. On several occasions he has requested a quotation from us which I have refused on the basis that the Head Office Sales Department did not have product available at that terminal."
>
> (Document #70607, August 26, 1970, Gulf)[177]

This excerpt indicates that Gulf informed Martin that it did not have product available to supply Martin. However, the following documentation which is dated a day later than the above quotation indicates that Gulf also contemplated placing restrictions on one of its customers — Pacific Petroleums — to reduce the problem that Martin was creating:

> "Marketing are concerned that the recent Pacific request for supply at Thunder Bay could mean that Pacific plan to provide product to Martin Petroleum. In view of our long-standing refusal to supply resellers in this area of price instability, Marketing recommend that any arrangement with Pacific should include the proviso that product would be moved in Pacific marked vehicles only."
>
> (Document #65587, August 27, 1970, Gulf)[178]

Yet another example of Gulf's considerations is provided by the following excerpt from Gulf's deliberations on a proposed agreement with Murphy. Once more, an arrangement was termed undesirable because a firm — Murphy, in this case — was "an aggressive price cutting marketer":

> "Further to your memorandum of the 2nd instant attaching a memorandum from Mr. D.J. Wright with reference to the above mentioned company. *This would appear to be very attractive from a refinery thruput [sic] viewpoint, but all we need in Western Canada to make some marketing departments fall flat on their faces is to allow an aggressive price cutting marketer, such as Murphy, to become established on the Prairies.*"
>
> (Document #78597, April 7, 1970, Gulf, emphasis added)[179]

Another instance of this philosophy is illustrated by the following excerpt. Gulf's Head Office recommended to the Refining Department that Gulf not supply a small oil refiner because it marketed at "cut-rate prices":

> "I discussed the matter of providing Spent Acid to Wills Oil Company in Vancouver with our West Coast people in late December. *Despite the fact that there is a small cash income for Refining it was strongly recommended that we do not give this small*

> *Oil Refiner any help at all. He turns out a substantial amount of reclaimed oil which hits the market at cut-rate prices. Any advantages he gets in cost can be expected to be reflected in some effect on our lubricant sales.*"
>
> (Document #71756, January 21, 1972, Gulf, emphasis added)[180]

Consistent with its actions of rejecting supply arrangements with price competitive marketers was Gulf's willingness to supply those firms which acted in a responsible fashion. Pioneer was Gulf's largest Private Brand Dealer (PBD) account in Ontario (Document # 32955)[181] and did not encounter difficulty obtaining supply because Gulf considered it to be operated like a major:[1]

> "When Mr. Blaser approved the SD122[2] on Friday, it was on the basis that this is an extraordinary, extra special case. We are not to deem this as a precedent to be followed if requests for similar volumes are received from others in the future.
>
> "Murray Hogarth's[3] operation is rather like a major with cross merchandising on the carwash. We might well have interest in purchasing this business some time in the future.
>
> (Document # 70887, October 20, 1970, Gulf)[182]

Similarly, Gulf was willing to enter into an arrangement with Union Oil of Canada because of its position as a "responsible" marketer. Union had a small refinery (8,000 barrels per day, 1974) in Prince George, British Columbia. In 1969, Gulf was informed that Union planned to expand its marketing network into Saskatchewan and Manitoba. In its evaluation of the desirability of providing Union with product, Gulf noted:

> "Union are *responsible marketers* following the line of all major companies in the areas in which it distributes and sells products."
>
> (Document #78317, November 3, 1969, Gulf, emphasis added)[183]

Subsequently, Gulf agreed to supply Union's new needs.

Another example of Gulf's willingness to supply less aggressive marketers can be found in Gulf's deliberations with regards to a supply agreement with the United Farmers of Alberta (UFA). Gulf was willing to consider supply because UFA had a relatively insignificant growth rate and were not price aggressive:

> "It may be argued that securing of the U.F.A. account would be preferable to the alternative of a processing agreement with another refiner because:

1. The Ontario Royal Commission, *Report on Petroleum Products Pricing* indicated that in April 1976 Pioneer ran 36 company-operated outlets (some with car washes) in Southern Ontario.
2. This was Gulf's nomenclature for a discount account.
3. President and General Manager of Pioneer.

(i) United Farmers are relatively stable marketers with an historical growth rate of only 3.1 per cent and it would be preferable to deal with them rather than with an aggressive refiner who might move the product by discount pricing."

(Document #60241, March 16, 1971, Gulf)[184]

Again, Gulf's Marketing Department approved a sale to Pacific Petroleums noting they were responsible marketers:

"*RE: GASOLINE PRICE — PACIFIC 66, THUNDER BAY*

Pacific 66 are responsible marketers and in our assessment have not been a factor in price deterioration in this area. We do not have any real concern as to the discount you offer on supply of their gasoline requirement. . . ."

(Document #73019, November 6, 1972, Gulf)[185]

One measure of the success of Gulf's policy is provided by the following communication from one of its customers. An independent, fearing that its supply would be cut off, pleaded that it had not caused an outbreak of price competition. In July, 1971, the president of Gasex Oil Ltd., E. Crevier, addressed a letter to J. McAfee, President of Gulf, stating:

"I was surprised to hear that word had reached you last month to the effect our Company was responsible for the start of a gasoline price war at the retail level in the Eastern Sector of Montreal. This information is false and it would appear that your informants levelled the finger at us most likely because we are a young company and in the throes of developping [sic] a chain of retail outlets (by acquisition and construction) which may affect their planned expansion.

"I address this letter to you so that the record be cleared and to inform you that *our Company's policy is not to 'Cut Prices' but establish ourselves under a brand name in Quebec and Ontario very similar to 'Pioneer'*. Already we have established our own Credit Card system.

"We have a product supply agreement with your Company which is expiring shortly and we would consider renewing this agreement for one or two years for basic yearly quantities Ex your Montreal Refenery [sic] as follows:

Premium Gasoline	1,500,000 gls.
Regular	3,000,000 "
Domestic Fuel Oil	2,000,000 "
Stove Oil	1,000,000 "
Bunkers	3,000,000 "

"We have already started negotiations with your representatives.

"As a further proof of the seriousness of our development policy we have acquired this past month 2 fair size home delivery distributors, have opened 3 new Resale Outlets and will be duilding [sic] and putting into operation over 20 outlets before the year is out.

"We are pleased with our association with your Company and wish to continue our good relations.

"This incorrect report has shocked me and I wish it should not stand in the way of our business relations."

(Document #79665-6, July 5, 1971, Gulf, emphasis added)[186]

Of importance is the fact that Mr. Crevier thought it necessary to assure Gulf that Gasex's object was not to cut prices; the nature of the assurance indicates that Gasex anticipated that if it priced aggressively, it would have had its supply cut off by Gulf.

As was the case with Shell, when the threat from private brands intensified in the early nineteen seventies, Gulf moved to a more formalized decision-making structure to implement the selective supply policy that it had been following. Responsibility for sales to private brand dealers was to be allocated to the Marketing Department while to the Supply Department was to be left the responsibility for sales to other refiners (Document #67101-2).[187] Liaison between the two, in the latter case, was worked out to ensure that sales to other refiners did not have an undue impact on Gulf's branded network (Document #63517).[188]

Formalization of relationships between the two departments also extended into the area of policy. Pricing guidelines were developed and selectivity was formally enshrined in the rules of operation. In a Refined Products Operation Committee meeting in May, 1973, it was stated that Gulf's "near term tactics" in the Private Brand Dealer (PBD) market were to negotiate "with better quality operators" (Document #66375).[189] The policy was restated in Gulf's 1973 First Quarter Review:

"GULF NEAR TERM TACTICS — P.B.D. MARKET

. . .

— EMPHASIZE *SELECTIVITY* BY NEGOTIATING WITH BETTER QUALITY AND RESPONSIBLE OPERATORS"

(Document #69151, August 22, 1973, Gulf)[190]

In the marketing chapter, the fact that Gulf moved to squeeze the independents at this same time by increasing wholesale relative to retail prices was developed at length. Increasing the selectivity of its supply policy was just one aspect of this more general policy — albeit an important one.

Gulf's selective supply policy was, of course, just an extreme variant of a price discrimination scheme. Therefore it is not surprising that Gulf also employed various forms of price discrimination. For instance, Gulf was often willing to sell product to independent marketers but not willing to enter a processing arrangement with them. The terms of a processing arrangement were

more favourable than direct sales.[1] When Elf approached Gulf for a processing arrangement, Gulf indicated a willingness only to offer product as a sale because it did not want to give Elf the benefits of a processing arrangement:

> "They are clearly trying to establish themselves in the Montreal market and a processing deal with Gulf should be of considerable assistance to them. . . .
>
> "Our recommendation is that we should be prepared to sell them the products but decline to give them the advantages of a processing agreement."
>
> (Document #75342, August 18, 1972, Gulf)[192]

Gulf's policy on not offering processing arrangements is again stated when another firm — Turbo — approached it.

> "Mr. Walker also stated that TURBO wanted to negotiate a processing agreement but that our policy is not to negotiate this type of agreement with non-refiners."
>
> (Document #66300, February 8, 1973, Gulf)[193]

Another indication of the discriminatory treatment that Gulf accorded certain customers can be found in the differentials charged for different grades of gasoline. The premium gasoline market was somewhat less competitive than the regular gasoline market. It has been the concern of some government inquiries that the differential charged at the pump between regular and premium grade gasoline has been too high.[2] Consistent then with Gulf's decision to discriminate against the independents generally in its supply arrangements was the policy which it adopted to charge non-refiners a greater differential for premium gasoline than refiners who generally received processing agreements. A Gulf document stated:

> "It was accepted by Marketing that sales agreements with other refiners usually carry lower differentials between Premium and Regular gasolines than is the case in the P.B.D. markets."
>
> (Document #66018, March 20, 1969, Gulf)[194]

In summary, Gulf used a selective supply policy, like Shell, to reduce the impact of unbranded firms in the market. As in the case of Imperial, there is an example of a communication from a firm being supplied promising to avoid

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1. Document #75334[191] of Gulf indicates that on the Prairies a differential existed of 1.1 to 2.1 cents per gallon between the price paid by its processing partners for gasoline and that paid by independents.

2. See: Petrol-A Report on the supply of Petrol to Retailers in the United Kingdom, The Monopolies Commission, London, HMSO 1965. Report of the Royal Commission on gasoline Price Structure, Victoria, British Columbia, Queen's Printer, 1966. Report of the Gasoline Marketing Enquiry Committee, Edmonton, Alberta, Queen's Printer, 1968.

price competition in the marketing sector. As with Shell, Gulf tightened the constraints imposed by this policy when the independent sector failed to abide by the rules of the game and engaged in price competition.

Texaco, the fourth major refiner, adopted a similar position on supplying the independents to that employed by Shell, Gulf, and Imperial. Texaco did not have excess capacity to the same extent as the other majors. It was also more reliant than the other majors upon access to product from external sources. Therefore it is not surprising to find both that Texaco did not supply many independents and that it carefully developed its supply policy so as not to disturb the branded retail market.

Like the other major refiners, Texaco adopted a supply policy that was intended to discriminate against price competitive marketers. Like Gulf, it had a policy of not entering into exchanges with jobbers or wholesalers (Document # 51225).[195] It also established a list of preferred customers, whom it was willing to supply. In a summary of the wholesale gasoline market, a Texaco memorandum listed "desirable" jobbers of gasoline as:

> "Simpson Sears — Cdn Tire, UCO. *T. Eaton Co* & *only* a few others."
>
> (Document #45870, undated, Texaco)[196]

These were the same type that Shell had classified as 'responsible' marketers.

Texaco's reason for listing these as "desirable" customers was the same as that used by Shell. Key to its classification of a customer was whether it was 'responsible' in the marketplace. An acceptable customer to Texaco was one which it perceived would tend to price within 2 to 3 cents of the branded companies. The following excerpt outlines some considerations concerning the terms under which Texaco would consider a long-term sales agreement with certain 'desirable' jobbers:

> "†*Long Term Agreement*
>
> Assumes
>
> 1. They will not use gasoline as a loss leader to depress retail mkt
> 2. *They will sell within 2 or 3¢ of branded*
> 3. This margin is necessary using their own credit etc etc.
> 4. They can market cheaper than our retailers
>
> ..."
>
> (Document #45870, undated, Texaco, emphasis added)[197]

Evidence adduced in the marketing volume shows that other majors perceived their brand to have a value of approximately 2 or 3 cents per gallon above the independents although their costs were much higher than 3 cents per

gallon above this sector. Therefore Texaco's classification of 'desirable' jobbers was the same as that used by Shell — the group that did not threaten the majors' branded price structure through price competition.

Texaco not only had a selective supply policy but it also demonstrated that it was capable of withdrawing supply from independents when they refused to abide by the rules. When an independent who was being supplied by Texaco in Sault Ste. Marie began to price competitively, Texaco took steps to withdraw supply from him. Texaco refused to continue supplying McAuley Fuels Limited because this small independent sold gasoline to a gas mart and to a dealer (Burns) whom Texaco had "closed-out" (Document # 48073).[198] Texaco did not refuse outright to supply McAuley; it increased prices to the point that, if they had been accepted by McAuley, he would no longer have been a threat.[1] Several excerpts from Texaco documents show the way in which this was done. The first set of communications, written in early August, 1968, indicate local Texaco authorities intended to try and increase prices to McAuley:

> ". . . propose to increase the price of gasoline to McAuley Fuels, . . . "
>
> (Document #48072, August 14, 1968, Texaco)[199]

The law department then advised the Texaco marketing personnel not to act precipitously by refusing to supply McAuley's customer — Burns — but to check to see whether some other means could be used — such as invoking an overlifting clause:

> ". . . the Law Department advised that as long as we had McAuley's direction we would have to fill Burns' unit, and that we could increase McAuley's price according to a clause in our S-207 Agreement, on 30 days' notice, or if we found that McAuley was buying more product than quantity indicated in his S-207 agreement we would possibly cut off at this point."
>
> (Document #48073, August 13, 1968, Texaco)[200]

The purpose behind Texaco's actions is summarized in the following:

> "It appears clear from Mr. Joynt's memo to the file of August 13th and your letter to me that *the Company is increasing McAuley's price because lately McAuley has been purchasing not only as a consumer but as a wholesaler reselling to two retailers* (one of which is a former Texaco dealer). One of these retailers is picking up the product in his own truck as an authorized agent of McAuley and delivering to his own outlet. By increasing our price to McAuley, the Company foresees that the price to the said retailers will be increased, (in fact, the aforementioned retailer taking delivery as McAuley's agent has already been advised that we would be pleased to sell to him directly at the posted dealer tank wagon price) or that McAuley will exercise its contractual right to terminate the trading agreement."
>
> (Document #48068-9, August 21, 1968, Texaco, emphasis added)[201]

1. See the volume on marketing where Shell is quoted as claiming it did not need ever to withdraw supply; it only had to increase prices in order to cut off an independent.

The outcome of the McAuley case was that Texaco notified McAuley Fuels Limited that if the contract was to be renewed, prices would increase. As a result, McAuley Fuels "signified its unwillingness" to renew the contract (Document #48062).[202]

Thus Texaco, like the other majors, developed a policy that discriminated against marketers who threatened the majors' high-cost, inefficient branded price structure. The variant of this policy that was adopted by each major refiner differed. It ranged from the imposition of higher wholesale prices upon the price competitive segment to the outright refusal to supply. Nevertheless the objective of each firm was the same. Thus each of the four national majors adopted policies in this area that were self-reinforcing and that tended to protect the high-cost inefficient distribution systems that they each possessed downstream in marketing.

(ii) *Restrictions Imposed to Control Indirect Sales to Independents*

The previous section has shown that the majors attempted to restrict the impact of price competitive marketers by negotiating direct sales and processing agreements primarily with firms whose marketing departments were not aggressive with respect to price competition. Attempts were also made to restrict refinery agreements to those companies regarded as 'responsible' in a second sense. Responsibility, in the case of a processee, was defined both in terms of its marketing practices and those of any company supplied by the processee. In this way, the majors attempted to ensure they did not indirectly supply price-competitive marketers, who were not 'responsible', through processing partners.

The documentation provides several examples of the type of restrictions that either were considered or were actually imposed on processees in order to prevent resale into the private brand market. In 1960, Royalite (later purchased by Gulf) decided that supply would be granted to an independent marketer (Mohawk) only on the condition that no resales would be made without Royalite's approval. A Royalite document noted:

> "It is agreed that Mohawk should be restricted from supplying any outlet or company unless we agree and that they will not form or be part of any new company to market petroleum products. On this basis, we could give them a supply agreement."
>
> (Gasoline Western, Document # 1103, November 14, 1960, Royalite)[203]

A second example is provided by Shell's documentation. Shell, in the early nineteen sixties, considered a processing agreement to cover Murphy's Quebec and Ontario requirements. The Executive Vice-President of Shell requested information on Murphy's marketing activities from the Shell marketing managers in its Central and Eastern Divisions. The Eastern Division

Manager was generally opposed to the proposed Murphy processing agreement, but indicated that if an arrangement ensued then Murphy should be limited to the marketing of gasoline and fuel oil through its own retail outlets:

> "1. *If Murphy limit the marketing of gasoline to their own brand name — 'Spur' — and in the manner they do at present, we could live with a pick-up out of Montreal Marketing Plant*, but would be reluctant to have them pick up at other Shell bulk plants.
>
> "However, *if they continue to sell gasoline to miscellaneous resellers, as at present, so that the product ends up in the retail trade, we would be definitely opposed to such a pick-up arrangement.*
>
> "2. *On the fuel oil side there would have to be the same sort of limitation. That is, a restriction to Murphy's own resale organization rather than indiscriminate sales by Murphy to other fuel oil resellers as has occurred under their present arrangement with Canadian Import.*"
>
> (Document #26266, October 2, 1963, Shell, emphasis added)[204]

In keeping with this approach, Shell evaluated the desirability of an exchange partner by examining the latter's disposition of product. The discovery of resales to independent price competitive marketers was sufficient cause for a recommendation that product arrangements not be made with a company. In late 1971, the Manager of the Eastern Marketing Region not only recommended withdrawing supply from price-aggressive independents, but also recommended re-evaluating exchange or processing arrangements with certain of the larger companies which supplied these independents:

> "The market is complicated by the fact that all pipeline plant companies — save Esso — are supplying unbranded mogas at prices which allow pump prices as low as 34.9 c.p.g. (see clipping).
>
> "I firmly believe that we should withdraw from supplying each of Martin, C.F.M. and Gasex at Ottawa — with the timing being only a matter of how quickly Retail can gear up its operation (which I suggest will be not less that 10 outlets in Ottawa/Hull and environs).
>
> "In the meantime I regard my position as the meaningful focal point on this issue and request that *all* decisions on supply, volume or price (including changes) be reviewed with me before any decision is taken.
>
> "*Included as well in this area of concern should be any exchange or purchase arrangements with Murphy, Golden Eagle — both of whom are active in the supply of unbrandeds.* I am aware that Golden Eagle marketers are very interested in access to pipeline storage. Murphy are interested in acquiring a plant site at Ottawa."
>
> (Document #34352, December 6, 1971, Shell, emphasis added in last paragraph)[205]

In this document, the Manager of Marketing in Shell's Eastern Region noted that if Shell was going to deal effectively with the independents by cutting off their supply, then it was not sufficient just to curtail direct sales to

the unbranded sector. Shell product that was reaching the independents via Shell's processees had to be controlled as well. Testimony from this Shell official established that if Murphy and Golden Eagle were going to continue supplying certain independents — Martin, C.F.M., or Gasex — then it was his recommendation that Shell not supply these firms:

> "Q. Were you concerned with whom Golden Eagle and Murphy, or to whom they supplied product?
>
> A. I suppose so, in re-reading this letter, I must have been.
>
> Q. Was your concern that Murphy or Golden Eagle might supply Martin, C.F.M. or Gasex?
>
> A. No, it is their posture to supply anyone.
>
> Q. I realize that.
>
> A. I could not possibly know what their intentions were.
>
> Q. Were you concerned that they might do it?
>
> A. My letter says so, yes.
>
> Q. Was it because of your concern that you suggested, or was it because of your concern that you were wondering about any exchange or purchase agreements between Shell and Murphy or between Shell and Golden Eagle?
>
> A. Yes, it would be.
>
> Q. Because, if Murphy were going to supply Martin, C.F.M. or Gasex, I take it Shell, if they could, would not want to supply Murphy?
>
> A. You take it incorrectly. There is no indication anywhere in this record that Murphy or Golden Eagle were going to supply any of those firms.
>
> Q. That was your concern?
>
> A. That was my concern about unbrandeds in general."
>
> (Testimony of A.G. Seager, General Manager of Marketing, Shell, Toronto Hearings, 1975, pp. 127-8, Vol. 1)[206]

The Shell Marketing Manager, then, was concerned that Shell was indirectly supplying marketers, who were not 'responsible'. Shell took steps to resolve this problem by refusing to process for Murphy when Murphy approached it for processing in 1973 (Document #27094).[207]

The established refiners also prevented processees from supplying the price competitors, who were not 'responsible' by other methods. In some cases, they considered imposing restrictions on the resale of product. In other cases, they restricted the amount of product to what they estimated were 'own use' requirements. Shell either actively considered or implemented both strategies. For instance, in 1973, Husky approached Shell for supply in the Prairies from Shell's proposed new refinery in Edmonton. In evaluating this proposal, a Shell official noted:

> "Presumably we would wish to satisfy ourselves that the product would be used to satisfy Husky's normal market only, i.e., *similar to present Pacific deal.*"
>
> (Document #27160, July 27, 1973, Shell, emphasis added)[208]

This statement not only indicates that Shell considered restricting Husky's supply to its "normal market", but also that such a restriction had, in fact, been imposed on Pacific Petroleums.

If it was suspected that the processee was asking for a volume greater than the amount that its own branded network would require, other similar restrictions on the marketing of the product were considered by Shell. A Shell official recommended that Husky's use of the product be restricted to its own branded sales:

> *"Some restrictions may be required on Husky's use of product from Shell, i.e., to their own branded market or whatever constraints Marketing feel may be needed."*
>
> (Document #27158, July 27, 1973, Shell, emphasis added)[209]

Shell also tried to prevent resale to the private brand market by setting a high supply price on the processed product. In the proposed Husky agreement, Shell noted that:

> "We would, of course, need to discuss this [prices — Husky supply agreement] in-house but it is imagined we would make them high enough to keep Husky honest, i.e., out of the discount market."
>
> (Document #27159, July 27, 1973, Shell)[210]

Shell had adopted a similar strategy in a proposed processing agreement with Murphy — as the following excerpt indicates:

> "Marketing's principal concern in connection with processing for a company such as Murphy is to ensure that the prices quoted do not encourage them to hold wholesale prices down at current low levels."
>
> (Document #32181, May 2, 1972, Shell)[211]

Other major refiners adopted similar policies to those described above. Texaco attempted to keep close control over sales to commercial customers so as to prevent product from finding its way to independent marketers of gasoline:

> ". . . the Company will not enter into S-207 Agreements with respect to the sale of gasoline to commercial consumers under which unrealistic quantities of gasoline are to be sold or in which the consumer will be granted a right to pick up with his own truck.
>
> "The Company should not be placed in a position of supplying product to a commercial consumer for resale to dealers who are competitive with the Company's own retail outlets."
>
> (Document # 48063, October 8, 1968, Texaco)[212]

Gulf also attempted to restrict the resale of product to the unbranded sector. As with Shell, the Gulf Supply and Transportation Department attempted to 'control' the amount of product resold by its processees by restricting their supply to cover only the processees' requirements for their own branded network. Sales of processees through their own retail network were to be monitored and supply restricted to these volumes. A Gulf document noted:

> "*To the extent possible every effort should be made to limit processing and sale agreements with other refiners to meet their own direct requirements.* This requires a detailed evaluation of the proposed processing or sale volumes by year and a narrow minimum/maximum range."
>
> (Document #71490, September 9, 1971, Gulf, emphasis added)[213]

It is evident from the following excerpt that one of the purposes of these restrictions was the protection of the status quo in the marketing system:

> "Processing agreements make a significant contribution to refinery economics and as long as the volumes supplied are in line with our competitors' normal market growth the impact on our own Marketing activities will not be excessive."
>
> (Document #73811, January, 1972, Gulf)[214]

Shell and Gulf were not the only majors to exert pressure on resellers in order to restrict discount marketers. Even though Imperial was not a large supplier of this market, it used its position to pressure others to control the supply of product to independents. This is illustrated by the following excerpt from a Tidewater report. This document recounts a meeting between Imperial and Tidewater to discuss the Winnipeg gasoline market. During the meeting Imperial informed Tidewater that it had pressured Shell to have Husky stop supplying a discounter — Dominion Motors. Since Tidewater was wholesaling Husky product to Dominion Motors, Imperial's actions can be interpreted as an indirect threat to withdraw supply from Tidewater. The Tidewater report recounted these details:

> "I was speaking to Jack Nunn, at Imperial in Edmonton, and he was aware of our selling gasoline to Dominion and as I understand it, he has put the pressure on Shell in Winnipeg to ask Husky to stop selling to Dominion. I can't tell at this point just what will happen, we went into a long discussion on the gasoline market in Winnipeg and I think we came out ahead. . . .
>
> "I believe it will continue as long as Doug Everett follows our suggestions as to selling price. He has agreed to do this as he has done in the past. With this in mind, I have no second thought about resuming gasoline deliveries."
>
> (Gasoline Winnipeg II, Document # 60, July 12, 1965, Tidewater (Veedol Oil Co.))[215]

It is significant that Tidewater, after its discussion with Imperial, reiterated that its position was to supply an independent only if it followed Tidewater's suggestion as to "selling price". For this was the intent of the majors' wholesale

policies — to restrict supply to independents and to maintain the discount brands' selling price at high levels in order to restrict the spread of this sector.

Imperial apparently succeeded in its goal in indirectly exerting influence over Tidewater via Husky. In the following year, Tidewater wrote to Husky complaining of the price they were being charged and pointed out:

> "You were speaking of a price on regular gasoline of 16 or 16.2 F.O.B. Winnipeg Refinery. I feel, Ray that we kept our end of the bargain, that we haven't caused any undue trouble in Winnipeg area or elsewhere. I can assure you of my continued co-operation in that matter."
>
> (Gasoline Winnipeg II, Document # 65, June 13, 1966, Tidewater (Veedol Oil Co.))[216]

It is also clear that Tidewater's understanding of its obligations were not based just on its conversation with Imperial. For Husky itself indicated that it had held discussion with Tidewater on dealer pricing practices:

> ". . . I have had discussions with Tidewater with regards to dealer pricing in the area and as I informed you verbally, I believe this matter has now once again been resolved."
>
> (Gasoline Winnipeg II, Document # 189, September 15, 1967, Husky)[217]

Additional evidence of the indirect pressure placed on discounters by the refiners is provided by events in the following year. When Dominion Motors reduced its retail price, Husky immediately informed Veedol — Tidewater's successor — that supply would be discontinued unless Dominion was persuaded to increase its price. Veedol then acted as a negotiator relaying the position of the two sides one to another:

> "As you are no doubt aware over the last four or five years we have been supplying Dominion Motors with gasoline. This is purchased from Husky Oil in Winnipeg and picked up at Shell Oil Companys' [sic] Refinery in St. Boniface. It is at present, and has been in the past, Dominion Motors [sic] policy to sell gasoline at anywhere from a 2¢ to 4¢ discount off major service stations [sic] posted price. While the major companys [sic] will allow a 2¢ spread they will not generally allow a 3 or 4¢ spread between gasoline prices.
>
> "On Tuesday, April 2, Dominion Motors made a decision to lower their gasoline prices to reflect 4¢ off major posted price. This was followed immediately by the Imperial Oil Station across the street from Dominions [sic] main gas station.
>
> "*Further to this I received a phone call from Husky Oil stating that unless I was successful in getting Dominion Motors to raise their gasoline price that there was a good chance that our gasoline supply would be discontinued.* I had a meeting with Dominion Motors and while I did not threaten them with discontinuing to sell their gasoline, I did point out what I felt might occur if their price stayed where it was. I was informed by Dominion Motors that they had know [sic] intention of raising their price and that if in fact their gasoline supply was cut off that they would take their case to the Combines Investigation Branch of the Federal Government.

"*I again spoke to Husky and it was their feeling at the time that perhaps the same result could be accomplished by raising Dominion Motors [sic] price.* Here again, I do not think that we had best get involved in arbitrarily raising prices for no other reason than to prevent Dominion Motors from discounting gasoline. I gave Husky my feelings on the subject.

"I had another meeting with Dominion Motors on Monday, April 8. *Senator Everett told me that if I could get the major companys [sic] to agree to a 3¢ a gallon price spread that he would immediately move his gas prices upwards to reflect the new margin.* I have passed this information onto Husky and am waiting results.

"It would appear as though Dominion Motors are prepared to fight this issue out in the courts if necessary. I would suggest that before this does happen that we make a decision to withdraw from the gasoline marketing situation. If we do in fact withdraw this would leave Dominion Motors in a very embarrassing situation as they have no other source of supply for gasoline. At this time importing gasoline into Winnipeg is a very costly venture particularly in view of the dollar devaluation."

(Gasoline Winnipeg II, Document # 291, April 10, 1968, Veedol Oil Co., emphasis added)[218]

Together these episodes show how the pervasive interdependence among refiners was used to transmit pressure from the majors all the way down the chain to wholesalers so as to discipline the discounters. They also show that the manner in which this was done was quite direct — that demands to move prices upwards were accompanied by threats of withdrawal of supply.

Other examples of communications suggest that company field representatives felt pressure could be exerted by head office to resolve pricing problems.[1] For instance, in the following excerpt, a Shell field representative reports on a competitive problem and refers it to head office:

"I have lately been hearing more & more verbal reports of heavy discounting by credit card route by the subject company. Today I have been able to obtain a copy of an invoice [serial 79] (the supplier of the invoice cut out his name, c/c # etc.) The net price per gallon charged is 37.9 c.p.g. for Regular gasoline which is our dealers [sic] cost! . . .

"*For your information and discussion with the subject management if possible!*"

(Gasoline Winnipeg II, Document # 80, March 27, 1968, Shell, emphasis added)[219]

Other quotations also suggest that discussions took place between companies at the refinery level in order to maintain discipline in the reseller market. For example, Gulf, in the following excerpt, notes that Imperial intended to cut off the supplier of Simpsons-Sears — a major discounter — unless:

1. More examples of this nature are found in the volume on marketing.

"FURTHER TO OUR CONVERSATION-YES, PHILIPS [sic] 66 ARE SUPPLYING SIMPSONS SEARS THRU AN EXCHANGE WITH I.O. THRU MOHAWK. *I AM TOLD IF THINGS DO NOT HAPPEN THEY WILL BE CUT OFF IF YOU GET WHAT I MEAN.* PHILLIPS 66 OFFICE IS IN CALGARY."

(Gasoline Winnipeg II, Document # 298, June 6, 1967, Gulf, emphasis added)[220]

It was knowledge such as this that the individual company strategies, which have been discussed previously, required in order to reinforce one another in an effective fashion. Gulf relied upon assurances from companies that it supplied that they would not supply independent marketers. When Union requested a supply of product on the Prairies, Gulf noted:

"They have avoided any disruptive moves to offer product into the reseller business and claim they have no interest in doing so. Union's requirement in Alberta is for their retail business only."

(Document #77875, September 20, 1972, Gulf)[221]

Gulf did not have to ensure such assurances were guaranteed in writing. Gulf knew that in the case of Union the agreement could be cancelled quickly if Union did not abide by its promise not to supply independents:

"The fact that our arrangement with Union can be cancelled on six month's [sic] notice give us the flexibility to continually review our position with them and to change our position as conditions warrant."

(Document #77875, September 20, 1972, Gulf)[222]

In summary, the majors did not rely only upon a refusal to supply the price marketers directly in order to restrict competition from this source, they also carefully monitored the resale policies of those firms which they did supply. Their efforts were aimed at withdrawing supply from those who were reselling to the price competitive segment. When reseller activity that threatened the majors' branded networks was discovered, the offending party was informed that its behaviour was unacceptable. Together these policies had the effect of discriminating against marketers whose marketing costs were lower than those of the majors' marketing network. These policies were aimed at preventing the independents from decreasing their prices towards their own cost levels. The ability of the majors to perpetuate their inefficient high cost marketing network attests to the detrimental effect occasioned by the monopolistic practices followed at the refining as well as the marketing level.

The efficacy of these practices can be attributed to the consistency with which they were employed by the major refineries. In this and preceeding sections, the similarity of the various companies' policies was developed at length in order to demonstrate their self-reinforcing nature. Evidence was adduced to show that the companies were aware of the importance of their each contributing to a 'strengthening' of the market and to restricting price competi-

tion. That reinforcing parallel actions were adopted in the refining sector is explained by the degree of interdependence that existed therein. The linkages that existed between companies at the refining level provided an efficacious manner of exerting pressure on fellow companies.

E. *Summary*

While competition was restricted at each level of this vertically integrated industry, neither the methods nor the effects were always the same. In the domestic production sector, the industry succeeded in coordinating the interests of a substantial number of firms. A small number of majors, at the core of a tightly-knit oligopoly, wielded authority over fringe members of the industry. But because of the number of firms involved, an explicit consensus had to be reached in order to establish the price setting mechanism. In the refining sector, this small group of majors who dominated the industry elsewhere did not face a large group of fringe firms. Therefore coordination did not require the same complex mechanism found in the production sector. In the production sector, activities served to create monopolistic conditions where they would not otherwise have developed; in the refining sector, the majors' activities served to entrench and protect a monopolistic situation that already existed.

Monopolistic conditions in the refining sector resulted in the first instance from the high level of concentration therein. The national majors controlled up to 90 per cent of refining capacity in the most concentrated regions and as low as 60 per cent in others. When the regional majors are included in the total, then the market shares of the majors — both national and regional — were uniformly around 90 per cent. Concentration levels such as these tend to create the type of interdependence that allows a concentrated oligopoly to function as a unit. In addition, the extent to which product was exchanged among firms and the degree to which the manufacturing process was coordinated among companies further tied the majors closely together in this sector.

Two aspects of the various inter-refinery agreements serve to show how closely the refiners were linked. First, the pattern of linkages was such that a set of bilateral arrangements tied all of the national majors together into one network. In addition, the linkages between each regional major and one or other of the national majors served to tie the latter into the main unit. Secondly, the nature of the agreements was complex. The complexity of the refinery arrangements required the type of coordination that would have served to mesh the interests of the separate parties. For example, the product exchange arrangements were often long term and involved more than one region. Sometimes they were characterized by substantial inter-firm communications and discussions regarding distribution systems, product demand and supply estimates and the timing of refinery construction and expansion. They also involved the assigning

of responsibility to specific members for capacity expansion. Agreements such as these are difficult to arrange with only tangential linkages between firms; they would have required a substantial meshing of the operations of the various participants. When firms in an oligopoly can mesh their interest with those of others, they together develop the type of control that is characteristic of a monopolistic situation.

The monopolistic conditions that developed in the industry were enhanced by the particular way in which the majors organized inter-refinery agreements. For example, Imperial and to a lesser extent Gulf, were the industry leaders in the refining sector. By the early nineteen seventies, both Imperial and Gulf had refining capacity in every region. Imperial and Gulf pursued the objective of controlling spare industry refining capacity. This strategy was meant to have the effect of discouraging the construction of refining capacity. It served to entrench their control over the disposition of product.

The objective of both Gulf and Imperial extended beyond just preventing the development of unrequired refinery capacity and excessive refinery expansion. The product arrangements that they and other refiners used were meant to maintain upward pressure on prices in the marketing sector and to reduce the number of marketers competing on the basis of price. The purpose of the refinery agreements was not just to rationalize the industry but to gain control by deterring entry and by strengthening interdependence in the refining sector.

The evidence from the refining sector shows that the refiners used the discretionary power associated with market control that they possessed. On some occasions, this power was exercised by one company alone. On other occasions it was exercised with some degree of coordination. Whether exercised singly or in conjunction with others, discretionary power served to entrench or to enhance the monopolistic position of the majors. In turn this served to reduce competition at the wholesale, and at the retail level in the marketing sector.

The majors used their discretionary power at the refining level to constrain competition downstream in marketing in several ways. First, they took care to arrange their product-supply agreements so as to reduce the possibility of competition among themselves. On the one hand, this involved appending restrictions, either explicitly or implicitly to supply agreements. Restrictions such as market sharing provisions, involving 'territorial exclusivity' or 'normal growth' clauses, served to restrict the ability of one party to grow at the expense of the other. On the other hand, it involved modifying or changing refinery agreements if one party did not follow the expected behavioural pattern of mutual forbearance in the marketing sector.

Secondly, the majors acted so as to discourage entrants to the refining sector. Potential entrants to refining were treated differently depending upon

their ability to compete with existing refiners. Firms with little chance of entering the refining sector were either not offered product on the same terms as existing refiners, or were denied it. If entry to refining did occur, the existing refiners would then offer to enter into product supply arrangements with the intent to 'control' the new firm and to mesh its interests with their own. This behaviour was accompanied by the recognition that interchange with major refiners would minimize the likelihood that price competition in marketing would develop. It was also accompanied by discrimination against firms which were known to be price competitors. In some cases, a supplier required an expression of intent on the latter's part not to act aggressively downstream in marketing.

Finally, the majors used their discretionary power at the refinery level to restrict supply to a third group — the independent marketers whose potential for entry to the refining sector was minimal. This was the group which offered the greatest competitive threat to the majors at the marketing level. With lower wholesale and retail costs, the independents could price well below the majors' branded networks and reduce the majors' market share. The majors responded to this threat with a highly selective, discriminatory supply policy. Direct sales for this group of non-refiners were restricted as much as possible to 'responsible' marketers— those who tended not to compete with price. In addition, the majors imposed restrictions on processees to ensure that they did not resell to those who were not 'responsible', ie. who were price marketers. Together, the analogous strategies that were adopted by the majors made access to supply difficult for all but those who agreed to abide by the majors' high cost marketing techniques.

A second manifestation of the way in which discretionary power at the refinery level was used against independents can be found in the squeeze tactics that were employed. In the late nineteen sixties, Imperial led a squeeze against the independents when it implemented a wholesale price increase at the same time as it used an allowance or consignment programme to keep retail prices low in areas of independent activity. In the early nineteen seventies, both Imperial and Shell actively sought to squeeze the profit margins of the independents through the two-fold approach of increasing wholesale prices while simultaneously decreasing their own retail prices. Gulf did the same. On occasion some of the majors communicated one with another in order to coordinate their attempts to restrict supply to the independent sector. It was the discretionary or monopoly power possessed by the major refiners that allowed the squeeze to be undertaken from the wholesale or refinery side.

The strategy that was invoked in the refining sector against independent marketers was an integral part of the system of allowances, consignment and second brand schemes that were used to discipline the independents in the

marketing sector. As is demonstrated in the marketing volume, the majors' actions were aimed either at eliminating the independent sector or at restricting its influence.

That policies at both the refining and marketing levels were directed toward the same goal is significant for two reasons. First, corroborative information from behaviour at both these levels of this vertically integrated industry strengthens the argument that the intent of the majors was predatory in nature. Secondly, it emphasizes the seriousness of the effect of these actions. It cannot be argued that the industry's anti-competitive practices only were invoked on isolated occasions. The fact that the actions of the majors were similar in both refining and marketing is indicative of a serious effort that was made to restrain competition. Because of the extensiveness of the practice, discretionary or monopoly power was more likely to result and, when it was employed, to have had an adverse effect upon performance.

That the refinery supply policies which served to restrain competition were extensively practised also owed itself the relationship existing among the majors. This relationship allowed them to further their common objectives. Because of the high level of concentration and the extent of inter-firm linkages brought on by product exchanges at the refinery level, the degree of interdependence that was engendered among the majors in this sector was extremely high. Many of the actions that served to link the interests of the group together or to contain competition from outsiders were accomplished by each firm acting on its own. Each was able to impose certain restrictions on exchange agreements because of the discretionary power conferred by the ownership of a refinery. Actions, such as the adoption by Texaco of squeeze tactics against the independents similar to those used by Imperial, were undertaken with full knowledge of the reinforcing effect such activity would have on a common goal. Such actions contributed to the development of the group's power as a whole. Separate acts based on individual discretionary power or devoted towards bolstering the group's power contributed to the maintenance of the majors' control downstream in marketing.

While the extent of interdependence that existed at the refinery level served to link the interests of the majors together, it was not the only factor that produced analogous policies aimed at similar objectives. In this respect, the refining sector resembled the marketing sector. In marketing, the majors studied the actions of the industry leader; evaluated these actions as being disciplinary or predatory; and then implemented their own policies which not only supported a common predatory objective but which also were best suited to each company's individual circumstances. While the adoption of similar policies in the marketing sector did not depend, in the first instance, upon explicit inter-firm communications, such communications did exist. Communications served to confirm that analogous policies and objectives were being followed and

to reduce misunderstandings that might spread rather than contain price wars. Similarly, in the refining sector, coordination was served both by the leadership role of the dominant firm and by certain inter-firm communications.

Leadership in the refining sector was provided by Imperial in both an indirect and a direct manner. Imperial sometimes chose to act indirectly by squeezing the margins of majors whose wholesale policies displeased it. In the early nineteen sixties, during the price squeeze aimed at the independents in Vancouver, Imperial noted that the "small unbranded has been severely pinched over this period" (Gasoline Western, Document # 1540)[223] but also observed that the larger unbranded stations still needed additional disciplining. The best attack on this problem was observed to be "through the supplying oil companies, probably by means of reduced profits" (Gasoline Western, Document # 1542).[224] This was the policy that Imperial implemented. Imperial used its retail pricing policy to pressure the other majors to re-evaluate their wholesale policies and to withdraw supplies from independents.[1]

While Imperial sometimes used its pricing policies to bring the policies of the other majors into line with its own, Imperial also communicated directly with other companies for this purpose. Examples of the pressures placed upon Western firms by Imperial to move the prices of independents upwards have been cited elsewhere.

Therefore Imperial played more than just a passive leadership role. Through discussions such as the one with Veedol on dealer prices, and with Shell on its marketing policies in the Maritimes, Imperial actively coordinated the majors' effort that was aimed at restricting price competition, particularly from the independent marketing sector.

While Imperial Oil provided leadership in the industry, other firms also played an active role in that they used their discretionary power against the independent sector. This is evidenced by communications that served to coordinate marketing or wholesale policies that would have restricted supply to the independents. For refining arrangements were accompanied by discussions that deepened the interdependence that existed and that facilitated the coordination of policies in the marketing sector. Understandings between companies that

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1. An excerpt from an Imperial document noted that it was their "policy whereby price-cut signs would appear at all of our outlets to ensure the maximum pressure on profits for other majors necessitating a new look by them where they supply unbrandeds at long 'discounts'." (Gasoline Western, Document # 1547)[225]

facilitated the coordination of policy were not necessarily specified in writing. When Gulf agreed to sell product to Union on the understanding that product would not make its way to independent marketers, there was no formal contractual specification to this effect, but oral communication took place to ensure that both parties understood what had been agreed upon. When Gasex wrote to Gulf explaining that it was not the source of a price war, it was referring to what it considered to be the implicit understanding that governed its product-supply arrangement with Gulf. When Pacific Petroleums informed Imperial that it was not interested in supplying independent marketers, it was communicating an understanding of what its responsibilities would have to be if it was to receive product. The understanding that allowed different refiners to harmonize their policies as to selective supply at the refinery level was facilitated by communications between companies.

The discussions that were held on product exchanges, the accompanying restrictions, and the extent of mutual dependence were such that each firm could follow the policy it did, knowing that the others would do so as well. When uncertainties arose as to whether each firm was following the appropriate policy, discussions would have served to reduce misunderstandings and reinforce the need to follow common goals and policies. The example of Shell being told by Imperial that the terms of a supply arrangement would be changed because Shell had been too aggressive is one such example.

Thus the anti-competitive effects of actions at the refinery level were the result both of the particular form of the contractual arrangements that were adopted therein and of some direct discussions.

Whether mutal understanding in the refining sector was arrived at because of the linkage of interests that were derived from specific tying arrangements, through the leadership of Imperial Oil, or because of direct communications is only of interest in establishing the instrument chosen by the industry to reach a consensus. This section has demonstrated that the manifestation of that consensus was a concerted effort to restrict competition downstream in the marketing sector.

In summary, the actions of the majors at the refining level were directed towards restraining competition in the marketing sector. Throughout the period examined here, the branded price structure in the marketing sector was continually threatened by the growth of more efficient marketers. At the refinery level, the majors followed a policy that had the effect of reducing competition downstream in marketing. Three different types of policies were used to this end. First, agreements among the major firms as to supply of product, mainly of a reciprocal nature, were used to remove the incentives each

would otherwise have had for independent action. Secondly, the existing refiners adapted to entrants in the refining sector by reconstituting their arrangements to make room for new firms and deliberately tied new firms to the existing refiners. This would have reduced the ability of the new firm to act independently and to compete downstream in marketing. Finally, the discretionary power that refinery ownership confered was used in a discriminatory fashion to select the type of firm which would be supplied, and the terms under which it would receive product. In doing so, refiners discriminated against price competitive marketers and, in particular, against independent distributors. Together, these practices served to restrain competition in the marketing sector.

APPENDIX A

Appendix A

The Northern Foothills Agreement

Refining was not the only sector where a type of joint operating agreement linked the majors together. In the production sector, various joint exploratory or producing agreements also served to mesh the interests of the majors together. Some of these arrangements were relatively small in scope. One company might drill on a small segment of land held by a second company in return for partial interest in any crude oil found. There were numerous such arrangements in the petroleum industry. But there were also arrangements that covered millions of acres or whole areas of the majors producing provinces.[1] The Northern Foothills agreement falls in the latter category.

The Northern Foothills Agreement was signed on April 17, 1945 by McColl-Frontenac Oil Company Limited (subsequently renamed Texaco Canada Limited), Imperial Oil Limited,[2] Shell Oil Company of Canada, Limited, Gulf Research and Development Company, and Socony-Vacuum Exploration Company (Mobil). Subsequently Texaco Canada Limited's interest was transferred to Texaco Exploration Canada Limited ("Texex"). The term of the agreement was to run for 24 years or to 1969.[3] In 1969 the original agreement was replaced by a group of agreements that dealt with the bonds in the original agreements.

The agreement covered a large area in Alberta and British Columbia, roughly forty million acres of land.[4] The accompanying map sketches the area that was included in the agreement. The express purpose of the agreement was "to carry out joint exploration for, and development of, oil and gas fields within the territory described".

The exploration and development of crude oil in the area covered was controlled by a management committee consisting of one representative from each of the signatories. The provision of personnel and of exploration expenses was shared on an equal basis. All information on the area of joint operations acquired by any party to the agreement had to be promptly made available to

1. For a description of how such extensive agreements were used in the Middle East to restrict exploration and production, see Blair, *The Control of Oil*, pp. 34, 81-85 and 82nd Cong., 2nd Sess., Senate Small Business Committee, *The International Petroleum Cartel*, Staff Report of the Federal Trade Commission, 1952, Chapter IV.
2. Imperial Oil withdrew from the agreement in 1948.
3. Various amendments and novation agreements were signed by the remaining parties to the agreement in 1956, 1957, 1958, 1960 and 1962 before change that occurred in 1969.
4. The 1945 agreement described the area in B.C. as all land lying to the Northeast of the main Rocky Mountain range, the acreage given was estimated from a 1966 Texaco map in which this was delineated.

the other parties. No exploratory well could be drilled in any prospective area unless each party was given the opportunity to contribute to its equal share of costs and to receive its equal share of production. Production from any oil field or pool was, subject to any limitation imposed by a government authority, to be maintained at a rate equal to the same total of the amounts desired by the enterested parties. No party could relinquish or surrender less than its entire right to all of the jointly owned mineral rights without written consent of the other parties to the agreement. If surrender of the entire right was being considered, then the party wishing to withdraw had to give written notice and offer to the others an assignment of all the interest in such mineral rights.

Comprehension of the effect and the extent of the agreement can be derived from an episode in early 1966. Texaco Canada Limited contacted its parent corporation Texaco Inc., indicating that it intended to bid on an area covered by the Northern Foothills Agreement (NFA) (Document # 46298).[226] Texaco Canada Limited had previously informed Texex of its intent to bid but was informed by Texex that it should not bid for two reasons. (Documents # 46298-9)[227] First, Texaco Canada Limited had received "a 2½% override on N.F.A. loads" on the understanding that it would not compete. Secondly, Texex was bound by the N.F.A. agreement to bid jointly with other partners on N.F.A. lands and Texaco Canada Limited along with Texex might be sued by the other partners if Texaco Canada Limited bid separately.

Texaco Canada Limited summarized the handicap these restrictions would place upon it with the following evaluation of the importance of the area covered by the Northern Foothills agreement:

> "We are very concerned that if we are prevented from bidding on such lands, it will negate our ability to appreciate on good prospective lands in which interest may be generated through our exploration work. The N.F.A. Group holds large blocks of lands throughout Northeastern British Columbia and our efforts to obtain production in this non-prorated area could be very sharply limited. Too, the N.F.A. Group hold large blocks in Alberta and the Northwest Territories and may acquire additional blocks in Western Canada."

(Document # 46299, February 1966, Texaco).[228]

In summary, the Northern Foothills agreement tied the interests of the Canadian subsidiaries of five of the largest multinational oil companies together in the early post-war period when oil exploration in western Canada rapidly developed domestic crude oil reserves. Like the refinery agreements that existed among the majors, production and exploration agreements such as this served to create a commonality of interests that contributed to their ability to act as a unit in other sectors of this vertically integrated industry.

APPENDIX B

Appendix B

Acquisition, On-Stream and Shut-Down Dates of Canadian Refineries 1946-1976

Year	*Acquisitions, Refineries Coming On-Stream, Refinery Shut-Downs*
1947	— Husky Oil & Refining Limited plant came on-stream at Lloydminster, Alberta.
1948	— Imperial Oil Limited plant came on-stream at Edmonton, Alberta.
1949	— Husky Oil & Refining Limited plant came on-stream at Moose Jaw, Saskatchewan.
1950	— Royalite Oil Company Limited plant came on-stream at Prince Albert, Saskatchewan.
	— Prince Albert Refineries Limited plant came on-stream at Prince Albert, Saskatchewan.
	— The British American Oil Company Limited acquired 77.37 per cent of Anglo-Canadian Oils Limited.
1951	— Imperial Oil Limited plant came on-stream at Winnipeg, Manitoba.
	— The British American Oil Company Limited plant came on-stream at Edmonton, Alberta.
	— Texaco Canada Limited plant came on-stream at Edmonton, Alberta.
1952	— Canadian Oil Companies Limited plant came on-stream at Corunna, Ontario.
	— Canadian Husky Oil Ltd. plant came on-stream at Fort William, Ontario.
	— Bonnyville Oil Refineries Limited plant came on-stream at Bonnyville, Alberta.
1953	— Sun Oil Company Limited plant came on-stream at Sarnia, Ontario.
	— Petroleum Fuels Limited plant came on-stream at Moose Jaw, Saskatchewan.
	— Royalite Oil Company Limited plant came on-stream at Coleville, Saskatchewan.
1954	— Royalite Oil Company Limited plant came on-stream at Kamloops, British Columbia.
1955	— Canadian Petrofina Limited plant came on-stream at Pointe-aux-Trembles, Quebec.
	— Pacific Petroleums, Ltd. plant came on-stream at Dawson Creek, British Columbia.
1956	— North Star Oil Limited plant came on-stream at Grande Prairie, Alberta.
	— Texaco Canada Limited acquired over 99 per cent of the shares of Regent Refining (Canada) Ltd.
1958	— Cities Service Company Limited plant came on-stream at Trafalgar Township, Ontario.
	— Petroleum Fuels Limited shut-down plant at Moose Jaw, Saskatchewan.
	— Prince Albert Refineries Limited shut-down plant at Prince Albert, Saskatchewan.
	— Bonnyville Oil Refineries Limited shut-down plant at Bonnyville, Alberta.
	— The British American Oil Company Limited plant came on-stream at Port Moody, British Columbia.
1959	— Royalite Oil Company Limited shut-down plant at Prince Albert, Saskatchewan.
	— Royalite Oil Company Limited shut-down plant at Coleville, Saskatchewan.
1960	— Irving Refining Limited plant came on-stream at Saint John, New Brunswick.
	— BP Refinery Canada Limited plant came on-stream at Ville D'Anjou, Quebec.

	— Canadian Oil Companies, Limited plant came on-stream at Innisfail, Alberta.
	— Pacific Petroleums, Ltd. plant came on-stream at Taylor, British Columbia.
	— Shell Oil Company of Canada Limited acquired North Star Oil Limited.
	— Texaco Canada Limited acquired McColl-Frontenac Oil Company (1960) Limited.
1961	— Golden Eagle Refining Company of Canada, Limited plant came on-stream at Holyrood, Newfoundland.
	— Anglo American Exploration Ltd. shut-down plant at Hartell, Alberta.
	— Pacific Petroleums, Ltd. shut-down plant at Dawson Creek, British Columbia.
1962	— The British American Oil Company Limited acquired Royalite Oil Company, Limited.
1963	— Shell Canada Limited plant came on-stream at Oakville, Ontario.
	— Husky Oil Canada Ltd. shut-down plant at Wainwright, Alberta.
	— Husky Oil Canada Ltd. acquired Wainwright, Alberta plant from Wainwright Producers & Refiners Limited.
	— Husky Oil Canada Ltd. shut-down plant at Lloydminster, Alberta.
	— Husky Oil Canada Ltd. acquired Lloydminster, Alberta plant from Canadian Kodiak Refineries Limited.
1964	— Texaco Canada Limited plant came on-stream at Halifax, Nova Scotia.
	— Husky Oil Canada Ltd. shut-down plant at Fort William, Ontario.
	— Shell Canada Limited shut-down plant at Grande Prairie, Alberta.
	— BP Refinery Canada Limited acquired Oakville, Ontario plant from Cities Service Refinery (Canada) Limited.
	— The British American Oil Company Limited acquired Brandon, Manitoba plant from Anglo-Canadian Oils Limited.
1965	— Royalite Oil Company, Limited acquired Anglo-Canadian Oils Limited.
1967	— Union Oil Company of Canada Limited plant came on-stream at Prince George, British Columbia.
	— La Raffinerie Irving du Québec Ltée plant came on-stream at Quebec City, Quebec and subsequently shut-down.
1969	— Gulf Oil Canada Limited (formerly The British American Oil Company Limited) shut-down plant at Brandon, Manitoba.
1971	— Gulf Oil Canada Limited plant came on-stream at Point Tupper, Nova Scotia.
	— Golden Eagle Canada Limited plant came on-stream at St. Romuald, Quebec.
	— Gulf Oil Canada Limited shut-down plant at Saskatoon, Saskatchewan.
	— Husky Oil Ltd. shut-down plant at Moose Jaw, Saskatchewan.
1973	- Newfoundland Refining Company Limited plant came on-stream at Come By Chance, Newfoundland.
1975	— Imperial Oil Enterprises Ltd. plant came on-stream at Edmonton (new Strathcona facility replacing former refinery on same site).
	— Imperial Oil Enterprises Ltd. converted their plants at Winnipeg, Manitoba; Regina, Saskatchewan and Calgary, Alberta into petroleum product distribution centres.
1976	— Newfoundland Refining Company Limited shut-down plant at Come By Chance, Newfoundland.
	— Husky Oil Canada Ltd. acquired Union Oil Company of Canada Limited.